SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948.

No. 668

THE UNITED STATES, PETITIONER,

vs.

HELEN W. BENEDICT and FRANK B. SMITH, as Trustees, *et al.*, etc.

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

INDEX

1 In the Court of Claims of the United States

No. 48463.

Helen W. Benedict and Frank B. Smith, as Trustees, and Leland E. Stowell and United States Trust Company of New York as Successor Trustees under the Will of John E. Andrus, Deceased, Plaintiffs,

against

United States of America, Defendant.

Petition—Filed Jan. 5, 1948.

To the Honorable the Court of Claims:

The above-named plaintiffs complain of the above-named defendant and allege as follows:

1. Plaintiff Helen W. Benedict resides at Yonkers, New York; plaintiff Frank B. Smith resides at Ocean Grove, New Jersey; and plaintiff Leland A. Stowell resides at Scarsdale, New York. Plaintiff United States Trust Company of New York is a corporation duly organized and existing under the laws of the State of New York, maintaining its principal office at 45 Wall Street, New York, New York.

2. Plaintiffs are the duly appointed, qualified and acting trustees of a trust created under the will of John E.
2 Andrus, who died a resident of the State of New York on December 26, 1934. A duly authenticated copy of the record of plaintiffs' appointment is attached hereto, marked Exhibit A and made a part hereof.

3. On or about July 7, 1944 plaintiffs filed in the office of the Collector of Internal Revenue for the Second District of New York a fiduciary income tax return on United States Treasury Form 1041 for the fiscal year ended April 30, 1944 and paid income taxes to the said Collector in respect of the liability for such fiscal year on July 7, 1944 and March 24, 1947 in the total amount of $5,480.35.

4. This suit is brought against the defendant, United States of America, pursuant to Section 24(20) of the Judicial Code of the United States.

5. This action arises under the laws of the United States provided for internal revenue, as hereinafter more fully appears.

6. On or about June 24, 1947 plaintiffs filed with the Collector of Internal Revenue for the Second District of New York a claim for refund of income taxes paid in respect of the fiscal year ended April 30, 1944 in the amount of $5,157.41.

7. Six months have elapsed since the filing of the claim for refund aforesaid and said claim has not been acted upon by the Commissioner of Internal Revenue or any other official of defendant, nor has the sum demanded been refunded or credited to plaintiffs.

8. Under the provisions of the trust created by decedent's will referred to in paragraph 2 herein, forty-five per cent (45%) of the net income of the trust estate was directed to be paid to Surdna Foundation, Inc., a corporation organized and existing under the laws of the State of New York exclusively for charitable purposes,
3 payments to which have been recognized by the Commissioner of Internal Revenue as deductible under the provisions of Section 162(a) of the Internal Revenue Code.

9. Pursuant to the provisions of the trust described in paragraph 8 herein, forty-five per cent (45%) of the net income of the trust for the fiscal year ended April 30, 1944, including $27,168.31 for its total capital gains, was permanently set aside for Sundra Foundation, Inc.

10. In preparing plaintiffs' income tax return for the fiscal year ending April 30, 1944 (referred to in paragraph 3 herein), only fifty per cent (50%) of said $27,168.31 capital gains was deducted in computing net income, the deduction claimed in the return being in the amount of $13,435.83.

11. Under Section 162(a) of the Internal Revenue Code, all of the capital gains permanently set aside by plaintiffs for Surdna Foundation, Inc., without any percentage or other limitations, were deductible in computing plaintiffs' net income. Allowance of this deduction in the proper amount, to wit, $27,168.31, reduces plaintiffs' income tax liability for the fiscal year ended April 30, 1944 by the amount of $5,157.41.

12. Plaintiffs have not assigned or transferred any part of the claim for refund upon which this action is based and are justly entitled to recover the amount claimed below.

13. Plaintiffs, and each of them, have at all times borne true allegiance to the Government of the United States and have not in any way voluntarily aided, abetted or given encouragement to rebellion against said Government.

14. The grounds for this action were set forth in the plaintiffs' refund claim.

4 WHEREFORE, the plaintiffs demand judgment against the defendant in the sum of $5,157.41 with interest as provided by law from July 7, 1944.

RATHBONE, PERRY, KELLY & DRYE,
By JOHN W. DRYE, JR.
Attorneys for Plaintiffs
Office and P. O. Address
No. 70 Broadway,
New York City, N. Y.

5 *Duly sworn to by Helen W. Benedict, et al. jurats omitted in printing.*
(all in italics)

7 *Exhibit "A" to Petition.*

No. 19752

Form 151

THE PEOPLE OF THE STATE OF NEW YORK,

To all to whom these presents shall come or may concern,

SEND GREETING:

KNOW YE, That we, having inspected the records of our Surrogate's Court in and for the County of Westchester, do find that on the 3rd day of March, in the year One thousand nine hundred and forty-two by said Court, Letters of Trusteeship under the will of

.... JOHN E. ANDRUS ....

deceased, were granted unto LELAND E. STOWELL in conjunction with UNITED STATES TRUST COMPANY OF NEW YORK as Successor Trustee, HELEN W. BENEDICT and FRANK B. SMITH to whom similar Letters were heretofore issued as Trustees of the trusts created in and by said Will, to wit: Paragraph Fourth (All assets of the trusts shall be retained in the sole and exclusive custody of the United States Trust Company of New York) and that it does not appear by said records that said letters have been revoked.

IN TESTIMONY WHEREOF, we have caused the seal of office of the Surrogate's Court of the County of Westchester to be hereunto affixed.

Witness, Honorable Charles H. Griffiths, Surrogate of our said County in the City of White Plains, the 23rd day of December, in the year of our Lord one thousand nine hundred and forty-seven.

Elmer L. Fingar
(Seal) *Clerk of the Surrogate's Court*

9 *General Traverse*

Filed January 9, 1948.

And now comes the Attorney General, on behalf of the United States, and answering the petition of the claimant herein, denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

(s) Theron L. Caudle,
E. B. D. *Assistant Attorney General.*

Argument and Submission of Case

On October 6, 1948, the case was argued and submitted on merits by Mr. Theodore Pearson for plaintiffs and by Mrs. Elizabeth B. Davis for defendant.

11 *Special Findings of Fact, Conclusion of Law and Opinion of the Court by Littleton, J. Dissenting Opinion by Madden, J.*

Filed January 3, 1949.

Mr. Theodore Pearson for the plaintiffs.

Mr. William H. Harrar and Messrs. Rathbone, Perry, Kelley & Drye were on the brief.

Mrs. Elizabeth B. Davis, with whom was Mr. Assistant Attorney General Theron Lamar Caudle, for the defendant. Mr. Andrew D. Sharpe and Mr. Lee A. Jackson were on the brief.

The terms of a will creating a trust required that 45% of the income of the trust be paid to a charitable corporation, and pursuant thereto such part of the total income of the trust for 1944 (after expenses), including long-term capital gains, was permanently set aside for such charitable use. The question is whether the trust is entitled under Section 162 (a) (26 U. S. C. 1946 Ed., § 162), to deduct on the fiduciary return 45% of the full amount of the capital gains of $60,374.01 so set aside, or only 50% thereof in view of Section 117 (a) (4) and (b), which provides, for the

purpose of computing taxable net income, that only 50% of long-term capital gains shall be included in determining *net* capital gain and *net* income, subject to the tax.

12 SPECIAL FINDINGS OF FACT

1. The plaintiffs are trustees of the trust created under the will of John E. Andrus, who died a resident of the State of New York on December 26, 1934. A fiduciary income tax return was filed for the fiscal year ended April 30, 1944, on July 10, 1944, showing a net income taxable to the fiduciary of $16,421.58 and tax due of $5,297.57 which plaintiffs paid July 11, 1944. Thereafter, upon examination of the return, the Commissioner of Internal Revenue determined the tax payable on the net income of $16,421.58 to be $5,480.35, and asserted a deficiency of $182.78 which plaintiffs paid together with interest of $23.97, on March 15, 1947.

2. Under the provisions of the trust provided under the will, 45% of the plaintiffs' income for the fiscal year 1944 was permanently set aside for the Surdna Foundation, Inc., a corporation organized, under the laws of the State of New York, exclusively for charitable purposes, payments to which are deductible as contributions under Section 23 (o) of the Internal Revenue Code. The will provided, so far as here material, as follows:

> FOURTH: All the rest, residue and remainder of my estate, real, personal or mixed, of any kind or nature and wheresoever situated, I give, devise and bequeath to * * * IN TRUST, * * * to collect and receive the rents, issues and profits thereof (hereinafter called "income") and after first paying therefrom all proper expenses to divide the net income into one hundred (100) parts, and to pay the same quarterly or at such other intervals as shall be convenient in the administration of the trust as follows:
>
> Forty-five (45) parts thereof to SURDNA FOUNDATION, INC., a corporation organized and existing under the laws of the State of New York.
>
> * * * * *
>
> On the termination of the trust, I direct my Trustees to transfer, convey, assign and set over forty-five (45) parts of the capital of the trust as it shall then exist to SURDNA FOUNDATION, INC., and the remaining fifty-five (55) parts to the persons receiving the income therefrom at the termination of the trust, in the same pro-

portions as they are then receiving the income thereof, and I give, devise and bequeath the same accordingly.

> FIFTH: I hereby authorize and empower my Trus-
> 13 tees to hold, sell, mortgage, exchange, lease, dispose, of, invest, reinvest manage operate and control the principal of the trust property in whatever form the same may at any time be during the continuation of the trust as fully and freely as I could have managed and disposed of the same if living without regard to any restrictions to which trustees are ordinarily subject, statutory or otherwise. * * *

3. The gross income of the trust of 1944, other than gain from capital assets, was $270,169.92. Plaintiffs had deductions of $29,602.19, leaving a balance of $240,567.73, which amount was also the amount currently distributable to beneficiaries. Plaintiffs had a gross long-term capital gain of $60,374.01, of which $30,187.01 was taken into account in computing taxable net income; said $30,187.01 was reduced by a 1942 carry-over of $329.60, leaving a balance of $29,857.41. In preparing the fiduciary return, plaintiffs deducted $13,435.83, 45% of the amount of $29,857.41, which represented Surdna Foundation's portion of said $29,857.41. Surdna Foundation actually got 45% of the $60,374.01. The computation made by the trustees left the amount of $16,421.58, which they reported on the return as "Net Taxable Gain Taxable to Trustee," said amount being the net income shown by the return, and the tax of $5,297.57 was computed thereon, as set forth above.

4. On June 24, 1947, plaintiffs filed a claim for refund of the tax paid for 1944 in the amount of $5,157.41. In the statement supporting the refund claim, the ground upon which refund is sought is set forth as follows:

> 45% of the income of the Trustees herein, under the will of the decedent John E. Andrus, is required to be paid or permanently set aside to Surdna Foundation, Inc., a New York charitable corporation. In computing the net income of the Trustees for the year ended April 30, 1944, instead of deducting $27,168.31 representing 45% of the income so paid or permanently set aside to Surdna Foundation, only $13,435.83 was deducted, the latter amount having been based upon the portion of capital gains taken into account.
>
> The Tax Court of the United States on August 16, 1946, determined in the case of the Trust under agreement, dated December 30, 1921, by John E. Andrus de-

ceased (Trust #1) 7 T. C. #70, that the entire
14 amount so paid or permanently set aside is deductible under Section 162 (a) of the Internal Revenue Code. The provisions of the Trust under the will of John E. Andrus are substantially identical with those of the Trust considered by the Tax Court in the above decision, insofar as the matter covered by the refund claim herein is concerned.

On the authority of said decision, request is made for the allowance of a deduction under Section 162 (a) of the Code of $27,168.31 in computing our net income requiring the refund claimed herein.

The claim had not been acted upon by the Commissioner of Internal Revenue prior to the filing of the petition herein nor has any portion of the sum demanded been refunded or credited to plaintiffs.

5. If the allowable deduction for charitable contributions is to be calculated on the basis of 45% of the aforesaid $29,857.41, judgment must be entered for the defendant. If said deduction for charitable contributions is to be calculated on the basis of 45% of the aforesaid total gain of $60,374.01, the amount of the allowable deduction would be $27,168.31 and the allowance of such amount as a deduction would result in an overpayment of income tax for the year ended April 30, 1944, in the amount of $4,962.43.

CONCLUSION OF LAW

Upon the foregoing special findings of fact which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiffs are entitled to recover $4,962.43, with interest as provided by law.

It is therefore adjudged and ordered that plaintiffs recover of and from the United States four thousand nine hundred sixty-two dollars and forty-three cents ($4,962.43) together with interest at six percent per annum on $4,755.68 from July 11, 1944, and on $206.75 from March 15, 1947, until such date as the Commissioner of Internal Revenue may determine in accordance with Section 117 (b) of the Judicial Code, as amended.

OPINION

LITTLETON, *Judge,* delivered the opinion of the court:

Under the terms of the fourth article of the will of John E. Andrus, creating a trust, 45% of the income of
15 the trust, including the income, gains and profits

derived from the sale or exchange of property of the trust, was required to be paid to the Surdna Foundation, Inc., a charitable corporation. The balance of 55% of such income was to be divided into certain stated amounts and paid to ten individuals (finding 2). As shown in finding 3, the trust had a gross income for the fiscal year ending April 30, 1944, not including long-term capital gains, of $270,169.92 from which there were allowable deductions of $29,602.19, leaving a net balance of $240,567.73, which was a part of the income of the trust distributable to the beneficiaries named under the fourth article of the will. In addition, the trust had further income consisting of gains and profits totaling $60,374.01, which amount was likewise distributable, derived from the sale of certain properties of the trust. These properties consisted of capital assets within the meaning of Section 117 (a) and (b), Internal Revenue Code (26 U. S. C. 1946 Ed., § 117), and had been held by the trust for more than six months. After deduction of expenses, forty-five percent of the entire income of the trust of $300,941.74 was paid to or permanently set aside by the trustees for the Surdna Foundation.

The question presented is whether the trust is entitled, in computing the net income upon which it may be taxable, to deduct, under Sections 22 and 162, U. S. C. 1946 Ed., Title 26, 45% of the full amount of the gains and profits of $60,374.01, or only forty-five percent of one-half thereof or $30,187.01 by reason of the "Capital Gains" provisions of Section 117 (a) and (b), U. S. C. Title 26. The pertinent provisions of the Internal Revenue Code relating to the question are set forth below.[1]

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[1] SEC. 22. GROSS INCOME

(a) GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of, or interest in such property; * * *.

(f) DETERMINATION OF GAIN OR LOSS.—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS

(a) COMPUTATION OF GAIN OR LOSS.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain * * *.

SEC. 117. CAPITAL GAINS AND LOSSES

(a) DEFINITIONS.—As used in this chapter—

*   *   *   *   *   *

(Continued on page 9)

16 The defendant says with respect to the gains and profits of $60,374.01, that the trust is entitled to a deduction for charitable contributions of only 45% of $29,857.41 thereof ($30,187.01 less a carry-over of $329.60) by reason of the provisions of Section 117 (a) and (b), which section, defendant insists, defines "gross income" in the case of a "long-term capital gain" for the purpose of the deduction provided in Section 162, and limits the definition of "gross income" and "gain from the sale of property," as set forth in Sections 22 (a) and (f), 162 (a) and 111 (a), respectively. We cannot agree. In our opinion the defendant's attempt to limit the deduction for charitable purposes of "any part of the gross income, without limitation," in part to *net income,* represents a narrow and strained construction of the several sections mentioned which, we think, was not in the mind of Congress or intended by it when the capital gains provisions of Section 117 were enacted. We think the principle announced in *Helvering* v. *Bliss,* 293 U. S. 144, and *United States* v. *Pleasants,* 305 U. S. 357, with reference to the intention of Congress not to place further limitations on charitable contributions and the limited purpose intended to be accomplished in connection with taxation of capital gains and deduction of capital losses, is applicable here and supports the plaintiffs' claim. Sections 22 and 111,

(Footnote 1 continued)

(4) Long-Term Capital Gain.—The term "long-term capital gain" means gain from the sale or exchange or a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * * * *

(b) Percentage Taken Into Account.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

Sec. 162. Net Income

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes * * *.

supra, define gains derived from the sale or disposition of property including capital assets. These gains,
17 as so defined, must be reported in the return and they are taxable as income in whole or in part under the capital gains provisions of Section 117, depending upon the length of time the assets had been held. The allowance under 162 (a) is out of total income rather than net taxable income. The liberal attitude of Congress as expressed in Section 117 with respect to the taxation of a capital gain by including only one-half thereof in net income, under certain circumstances, was not intended, in our opinion, to modify the definition of gross income. In this case the trust had a gain of $60,374.01 within the meaning and under the plain language of Sections 22 and 111, and, for the purpose of the deduction provided in Section 162 (a), that gain was a part of the gross income of the trust. The percentage limitation, set forth in Section 117, was enacted for the sole purpose of giving lighter tax treatment to certain capital gains and ought not to be read into Section 162 (a) for the purpose of limiting the amount of the deduction for charitable contributions. The original purpose intended by the capital gains provisions was retained. Section 162 (a), like Sections 22 and 111, deals with gross income and total gains and profits for the taxable year out of which the charitable contributions are made. Section 117 deals only with *net* capital gain, *net* capital loss and *net* income which is to be subjected to the tax. The total gain of the taxpayer is nevertheless the gain defined by Sections 22 and 111, and must be considered and reported as gross income in the first instance. This must be true because Section 117 taxes the entire gain as net income under certain circumstances.

The total gain must be classified in the computation of *net* taxable income according to the periods through which the various assets have been held and this classification is made solely for the purpose of the special tax on capital gains, based on the adventitious point of how long the asset had been owned and held by the taxpayer before it was disposed of. *Lockhart* v. *Commissioner,* 1 T. C. 804, 807.

In our opinion the ordinary and natural meaning of the language of Sections 22 and 111, *supra,* support the views we have expressed above, and we cannot find in the language of Section 117, or the reports of the Congres-
18 sional committees thereon, any support for the position that Congress intended thereby to limit or

modify the term "gross income," as used in Sections 22 and 162 (a), for the purpose of determining the amount of the deduction for charitable contributions by estates or trusts. In our opinion the decision of the Tax Court in *John E. Andrus Trust No. 1* v. *Commissioner*, 7 T. C. 573, which involved the same question we have here, was correct, and we are unable to concur in the decision of the Court of Appeals in *Commissioner* v. *Central Hanover Bank & Trust Co.*, 163 Fed. (2d) 208, 210, in which the court said;

> Accordingly the amount of long-term capital gain not taken into account under § 117 does not constitute gross income of the trust under § 22 (a). And, since the deduction allowed by § 162 (a) is restricted to payments made out of "gross income," the deduction here must be limited to that portion of the charitable gift which was made out of statutory gross income.

We cannot escape the conclusion that the above holding limits the deduction for charitable contributions in part to net income. In our opinion Section 117 (a) (4) recognizes as gross income the entire gain defined by Sections 22 and 111, and then classifies such gain as a "long-term capital gain" for special treatment in computing net income only if the asset from which such total or gross gain was derived, had been held for more than 6 months.

Plaintiffs are entitled to recover, and, under finding 5, judgment will be entered in their favor for $4,962.43 with interest as provided by law. It is so ordered.

HOWELL, *Judge;* WHITAKER, *Judge;* and JONES, *Chief Judge*, concur.

DISSENTING OPINION

MADDEN, *Judge*, dissenting:

I am unable to agree with the decision of the Court. My reasons are, in general, those given by the Court in *Commissioner* v. *Central Hanover Bank and Trust Co.*, 163 Fed. (2d) 208.

19 *Judgment of the Court*

At a Court of Claims held in the City of Washington on the 3rd day of January, A. D., 1949, judgment was ordered to be entered as follows:

Upon the special findings of fact which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiffs are entitled to recover.

It Is Therefore Adjudged and Ordered that plaintiffs recover of and from the United States four thousand nine hundred sixty-two dollars and forty-three cents ($4,962.43) together with interest at six percent per annum on $4,755.68 from July 11, 1944, and on $206.75 from March 15, 1947, until such date as the Commissioner of Internal Revenue may determine in accordance with Section 117 (b) of the Judicial Code, as amended.

21 Clerk's Certificate to foregoing transcript omitted in printing.

☆ U. S. GOVERNMENT PRINTING OFFICE: 830482 NO. 17----1949

Supreme Court of the United States

Order allowing certiorari—Filed May 2, 1949

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ. The case is transferred to the summary docket.

INDEX

CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 668

UNITED STATES OF AMERICA, PETITIONER

v.

HELEN W. BENEDICT AND FRANK B. SMITH, AS TRUSTEES, AND LELAND E. STOWELL AND UNITED STATES TRUST COMPANY OF NEW YORK AS SUCCESSOR TRUSTEES UNDER THE WILL OF JOHN E. ANDRUS, DECEASED

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Claims entered in the above-entitled cause on January 3, 1949.

OPINION BELOW

The opinion of the Court of Claims (R. 7-11) is reported in 81 F. Supp. 717.

JURISDICTION

The judgment of the Court of Claims was entered on January 3, 1949 (R. 11-12). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1255(1).

QUESTION PRESENTED

Whether, under Section 162(a) of the Internal Revenue Code, a trust is entitled to measure its maximum allowable deduction for charitable contributions against the total amount of its long-term capital gains despite the fact that only half of those gains are taken into account for income tax purposes under Section 117(b) of the Code.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and Regulations are set forth in the Appendix, *infra*, pp. 8-12.

STATEMENT

The special findings of fact of the Court of Claims (R. 5-7) may be summarized as follows:

Respondents are trustees under the will of John E. Andrus. This will provided for the creation of a trust which directed the trustees, after paying necessary expenses, to divide the net income into 100 parts, 55 parts to be paid to certain individuals and 45 parts to the Surdna Foundation, Inc., a charitable corporation. Under the terms of the trust, 45% of the corpus upon its termination was to go to the Surdna Foundation and 55% to named individuals. (R. 5-6.) The Surdna Foundation is

a corporation duly organized under the laws of New York exclusively for charitable purposes, payments to which are deductible as contributions under Section 23(o) of the Internal Revenue Code (R. 5). Under the provisions of this trust, 45% of its income for the fiscal year 1944, the period involved in this suit, was permanently set aside for the Surdna Foundation (R. 5).

On the federal income tax return for the trust for the fiscal year ended April 30, 1944, the gross income of the trust, other than gain from capital assets, was shown as $270,169.92. The trust had deductions of $29,602.19, leaving a balance of $240,567.73, which was the amount currently distributable to beneficiaries. The trust had a gross long-term capital gain of $60,374.01 of which $30,187.01 was taken into account in computing taxable net income. This amount of $30,187.01 was reduced by a 1942 carry-over of $329.60, leaving a balance of $29,857.41. The respondents, on the fiduciary return, deducted $13,435.83, 45% of $29,857.41, which represented Surdna Foundation's portion of such amount. This left the amount of $16,421.58 which was reported on the return as "net taxable gain taxable to trustee." Surdna Foundation actually got 45% of the $60,374.01. (R. 6.)

The respondents filed a timely claim for refund contending that in computing the net income of the trust, 45% of the total capital gains realized, instead of 45% of the amount of $29,857.41, should

have been deducted, and claiming this amount as a deduction. The claim had not been acted on by the Commissioner of Internal Revenue when this suit for refund was commenced. (R. 6-7.)

On the foregoing findings of fact, the Court of Claims, one judge dissenting, held that the respondents were entitled to deduct $27,168.31, being 45% of the total capital gain of $60,374.01, and rendered judgment accordingly in favor of the respondents (R. 7-11).

REASONS FOR GRANTING THE WRIT

1. The judgment of the Court of Claims is in direct conflict with that of the Court of Appeals for the Second Circuit in *Commissioner* v. *Central Hanover B. & T. Co.*, 163 F. 2d 208, certiorari denied *sub nom. Trust of Andrus* v. *Commissioner*, 332 U. S. 830. That case involved an identical question in connection with an *inter vivos* trust created by John E. Andrus, the decedent herein, which contained substantially the same provisions, including that for distribution of 45% of the net income of the trust to the Surdna Foundation, as does the testamentary trust involved in this case. The Court of Appeals for the Second Circuit held that the *inter vivos* trust could deduct, under Section 162(a) of the Internal Revenue Code (Appendix, *infra*, pp. 11-12), only 45% of the portion of the capital gain, paid to or set aside for Surdna Foundation, which was taken into account in computing net income under Section 117 of the Code

(Appendix, *infra*, pp. 9-11);[1] whereas the Court of Claims in the present case held that the testamentary trust could deduct, under Section 162(a), 45% of the total capital gain paid to or set aside for the benefit of Surdna Foundation, even though only one-half of the gain was taxable income. The two courts agreed that the term "gross income" in Section 162(a), which may be deducted if paid or set aside for charitable purposes, means "gross income" as defined in Section 22(a) of the Code (Appendix, *infra*, p. 8). However, they differed as to whether Section 117(a)(4), which defines a long-term capital gain as the gain from sale or exchange of a capital asset held for more than six months "to the extent such gain is taken into account in computing net income," is a definition of the gain which constitutes gross income under Section 22(a). The Court of Claims expressly recognized that its decision was in conflict with that of the Court of Appeals for the Second Circuit in the *Central Hanover* case, *supra*, in its statement (R.

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[1] That case involved the year 1941 and Section 117(b) of the Code then provided that 50%, 66⅔%, and 100%, respectively, of the gain upon sale of capital assets should be taken into account, depending upon whether the capital asset had been held for more than 24 months, between 18 and 24 months, or less than 18 months. This provision was changed by Section 150 of the Revenue Act of 1942, c. 619, 56 Stat. 798, to provide that 50% of the gain should be taken into account if the asset had been held for more than six months and 100% if less than six months. This is the governing provision in the instant case. Section 117(b) of the Internal Revenue Code. However, this change in the law does not affect the question here presented.

11) that it was unable to concur in the *Central Hanover* decision.

2. The question in this case is an important one, which should be settled by this Court. The problem will be a recurring one, since there are numerous trusts which are required to pay or set aside parts or all of their income for charitable purposes, and such trusts will undoubtedly realize at times capital gains from sale or disposition of their assets.[2] For administrative purposes it is essential to have the proper rule declared, particularly in view of the presently existing conflict between this case and *Commissioner* v. *Central Hanover B. & T. Co.*, *supra*. Further, the importance of the question is enhanced by the fact that the opinion of the Court of Claims in effect allows such trusts a double deduction, namely, exclusion from gross income under Section 117(b) of a part (here 50%) of the total gains realized and, second, a deduction under Section 162(a) of the total amount of the gains paid or set aside for charity, one half of which represents the capital gains already excluded from income. We do not believe that such a result was intended by Congress.

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[2] The *inter vivos* trust involved in the case of *Commissioner* v. *Central Hanover B. & T. Co.*, *supra*, has already filed a suit in the Court of Claims for the years 1938 and 1939 seeking refund upon the same ground as is involved in the instant case (*Central Hanover Bank and Trust Co.* v. *United States*, C. Cls. Docket No. 48835).

CONCLUSION

It is, therefore, respectfully submitted that this petition for a writ of certiorari should be granted.

PHILIP B. PERLMAN,
Solicitor General.

APRIL, 1949.

Internal Revenue Code:

Sec. 21. Net Income.

(a) *Definition.*—"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

* * * * *

(26 U.S.C. 1946 ed., Sec. 21.)

Sec. 22. Gross Income.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 1946 ed., Sec. 22.)

Sec. 117 [as amended by the Revenue Act of 1942, c. 619, 56 Stat. 798, sec. 150(a), (c)]. Capital Gains and Losses.

(a) *Definitions.*—As used in this chapter—

* * * * *

(2) *Short-term capital gain.*—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such gain is taken into account in computing net income;

(3) *Short-term capital loss.*—The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such loss is taken into account in computing net income;

(4) *Long-term capital gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing ~~net income;~~

(5) *Long-term capital loss.*—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such loss is taken into account in computing net income;

(6) *Net short-term capital gain.*—The term "net short-term capital gain" means the excess of short-term capital gains for the taxable year over the short-term capital losses for such year;

(7) *Net short-term capital loss.*—The term "net short-term capital loss" means the excess of short-term capital losses for the

taxable year over the short-term capital gains for such year;

(8) *Net long-term capital gain.*—The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year;

(9) *Net long-term capital loss.*—The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

* * * * *

(b) *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * * *

(26 U.S.C. 1946 ed., Sec. 117.)

SEC. 161. IMPOSITION OF TAX.

(a) *Application of Tax.*—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

* * * * *

(b) *Computation and Payment.*—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

* * * * *

(26 U.S.C. 1946 ed., Sec. 161.)

Sec. 162. Net Income.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

* * * * *

(26 U.S.C. 1946 ed., Sec. 162.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.162-1. *Income of Estates and Trusts.* —* * *

From the gross income of the estate or trust there are also deductible (either in lieu of, or in addition to, the deductions referred to in the preceding paragraph of this section) the following:

(*a*) Any part of the gross income of the estate or trust for its taxable year which, by the terms of the will or of the instrument creating the trust, is paid or permanently set aside during such year for the charitable, etc., uses or purposes referred to or described in section 162(a). ~~This deduction is in lieu of that authorized by section 23(o) in the case of individual taxpayers.~~

* * * * *

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INDEX

CITATIONS.

Cases:

In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 45

UNITED STATES OF AMERICA, *Petitioner*

v.

HELEN W. BENEDICT and FRANK B. SMITH, as Trustees, and LELAND E. STOWELL and UNITED STATES TRUST COMPANY OF NEW YORK as Successor Trustees under the Will of JOHN E. ANDRUS, DECEASED.

On Writ of Certiorari to the United States Court of Claims

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 4-11) is reported at 81 F. Supp. 717.

JURISDICTION

The judgment of the Court of Claims was entered on January 3, 1949. (R. 11-12). The peti-

tion for a writ of certiorari was filed on March 23, 1949, and was granted on May 2, 1949. (R. 12.) The jurisdiction of this Court rests on 28 U.S.C., Section 1255 (1).

QUESTION PRESENTED

Whether, under Section 162 (a) of the Internal Revenue Code, a trust is entitled to measure its maximum allowable deductions for a gift to charity against the total amount of its long-term capital gains set aside for the charity despite the fact that only one-half of those gains is taken into account as taxable income under Section 117 (a) and (b) of the Code.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and regulations are printed in the Appendix, *infra*, pp. 40-52.

STATEMENT

The special findings of fact of the Court of Claims (R. 5-7) may be summarized as follows:

Respondents are the trustees of a trust[1] created by the will of John E. Andrus, who died on December 26, 1934. The trustees were directed, after paying necessary expenses, to divide the net income of the trust into 100 parts, 55 parts to be paid to certain individuals and 45 parts to the

[1] Under Section 161 of the Internal Revenue Code (Appendix, *infra*, p. 48), a trust is a taxable entity and the tax due from it is to be paid by the fiduciaries. The term "taxpayer", when used herein, will refer to the trust.

Surdna Foundation, Inc., a charitable corporation. Under the terms of the trust, 45 percent of the corpus upon its termination was to go to the Surdna Foundation and 55 percent to named individuals. (R. 5-6.) The Surdna Foundation is a corporation duly organized under the laws of New York exclusively for charitable purposes, payments to which are deductible as contributions under Section 23 (o) of the Internal Revenue Code. (R. 5.) Under the provisions of the trust, 45 percent of the trust income for the fiscal year ended April 30, 1944, the period involved in this suit, was permanently set aside for the Surdna Foundation. (R. 5.)

On the federal income tax return for the trust for the fiscal year ended April 30, 1944, the gross income of the trust, other than gain from sale or disposition of capital assets, was shown as $270,-169.92. The trust had deductions of $29,602.19, leaving a balance of $240,567.73, which was the amount currently distributable to beneficiaries. The trust had a gross long-term capital gain of $60,374.01, of which $30,187.01 was taken into account in computing taxable net income. This amount of $30,187.01 was reduced by a 1942 carry-over of $329.60, leaving a taxable balance of $29,857.41. On the fiduciary return, the trustees deducted $13,435.83 (45 percent of $29,857.41), which represented Surdna Foundation's portion of such amount. This left the amount of $16,421.58 which was reported on the return as "Net Taxable

Gain Taxable to Trustee." There was actually set aside for Surdna Foundation 45 percent of the $60,374.01, or $27,168.31. (R. 6.)

The trustees filed a timely claim for refund in which the amount of $27,168.31 was claimed as a deduction on the ground that in computing the net income of the trust, 45 per cent of the total capital gains realized, instead of 45 per cent of the amount of $29,857.41, should have been deducted. The claim had not been acted on by the Commissioner of Internal Revenue when this suit for refund was commenced. (R. 6-7.)

On the foregoing findings of fact, the Court of Claims, one judge dissenting, held that the trust was entitled to deduct $27,168.31, which is 45 per cent of the total capital gain of $60,374.01, and rendered judgment accordingly in favor of the trustees. (R. 7-11.)

SPECIFICATION OF ERROR TO BE URGED

The Court of Claims erred in failing to hold that the trust is entitled to deduct only the taxable portion of the capital gain set aside for Surdna Foundation.

SUMMARY OF ARGUMENT

The trust in this case actually received a capital gain of about $60,000, and only some $27,000 of that amount was set aside for charitable purposes, the remainder being available for non-charitable beneficiaries. Yet, the Court of Claims has held

that less than $3,000 is taxable. A careful analysis of the statute discloses that no such bizarre result is required. The decision of the Court of Claims is inconsistent with the legislative history as well as with the uniform administrative practice. The contrary result was correctly reached by the Court of Appeals for the Second Circuit.

A. Section 162 (a) of the Code authorizes a trust to deduct any part of its "gross income", without limitation, which pursuant to the terms of the will is permanently set aside for charity. It has been held that the term "gross income" in this statute means gross income of the trust under Section 22 (a) of the Code. In the case of the long-term capital gain here, the amount "taken into account" in computing net income under Section 117 (b), that is, 50 per cent thereof, is the gross income from the gain for purposes of Section 22 (a). If this were not so, and the entire long-term capital gain constituted gross income under Section 22 (a), one would expect to find some provision in the Code under which the non-taxable portion of the gain is deductible or excludible. But there is no such provision and, it follows, necessarily, that only that part of the gain taken into account under Section 117 (b) is to be included in gross income. This is confirmed by the definition provision of Section 117 (a), to the effect that capital gain for tax purposes is the gain on sale or exchange of a capital asset to the

extent the gain is taken into account. When, as in the case of long-term capital gains, only 50 per cent is taken into account, that 50 per cent and no more is the "gain" which is includible in "gross income" under Section 22 (a).

The legislative history of Section 117 confirms that it was the intention of Congress, in enacting the statutory provisions just discussed, that only the percentage of capital gain taken into account in computing net income was to constitute gross income.

Section 117 has been so interpreted administratively consistently from the Revenue Act of 1934 when the system of taking only a percentage of the gain into account according to the period the asset had been held was inaugurated. On the tax return forms issued for 1934 and for each year since, the computation of the entire gain is required to be shown in a schedule, but only the percentage to be taken into account is carried forward and included in the items of gross income. This administrative construction has received the approval of Congress since the statutory provisions have been reenacted several times without significant change.

Finally, *Commissioner* v. *Central Hanover B. & T. Co.*, 163 F. 2d 208 (C.A. 2d), certiorari denied, *sub nom. Trust of Andrus* v. *Commissioner*, 332 U.S. 830, held, in square conflict with the decision in this case, that only the percentage of gain taken into account in computing net income

represents gross income under Section 22 (a). The other pertinent cases are consistent with this holding.

B. In any event, the term "gross income" in Section 162 (a) should not be construed so as to allow a deduction of the nontaxable portion of the capital gain set aside for charity. The purpose of Section 162 (a), which was to encourage charitable gifts by exempting them from income tax, is served if that portion of the capital gain given to charity is relieved of tax. At the same time, the intention of Congress, expressed in Sections 161 and 162 (b) and (c), that the part of the gain, to the extent it is taxable income, held for other beneficiaries, shall be taxed, is carried out. This would not be true if the trust is permitted to compute the deduction in such manner as to exempt from tax a part of the gain held for private beneficiaries which was meant to be taxable to the trust. A further reason for construing the statutory provision to measure the trust's deduction by the taxable part of the gain set aside for charity is that it is necessary to do so in order to prevent the equivalent of a double deduction which would otherwise arise through the exclusion from taxable income of one-half of the gain given to charity and the deduction from other income (that held for individual noncharitable beneficiaries) of the entire gain so set aside, including the one-half of the gain already excluded from income. A construction of Section 162 (a) which

will not permit the equivalent of a double deduction would be especially consonant with Congressional policy as exhibited in Section 24 (a) (5) of the Internal Revenue Code, which prohibits the deduction "in any case" of an amount, otherwise allowable as a deduction, which is allocable to income wholly exempt from income tax.

C. Since only half of the capital gain was "taken into account" and therefore constituted "gross income" either under Section 22 (a) or Section 162 (a), the trust's allowable deduction under the precise words of Section 162 (a) consists of the part (45 per cent) of this half of the gain which was set aside for Surdna Foundation. This gives a deduction for the part of the "gross income, without limitation" which was set aside for charity. The words "without limitation" in Section 162 (a) were intended, and operate, only to remove in the case of trusts and estates the 15 per cent of net income limitation which applies to the deduction of charitable contributions by individuals.

ARGUMENT

The Trust's Allowable Deduction Under Section 162 (a) of the Internal Revenue Code in Respect of Its Income From Capital Gains Is the Taxable Portion of the Gain Set Aside for Charity

Section 162 (a) of the Internal Revenue Code (Appendix, *infra*, pp. 48-49) allows to trusts a deduction, in lieu of the deduction for charitable

contributions authorized for individuals by Section 23 (o), of

> any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside

for charitable purposes. There being no dispute as to the right of the trust in this case to deduct the amount of its ordinary income which was set aside for the Surdna Foundation,[2] the only question is the proper measurement of its deduction in respect of its income from capital gains.

The trust realized during 1944 a capital gain of $60,374.01[3] but, because the capital assets disposed

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[2] The ordinary net income of $240,567.73 was all currently distributable to beneficiaries and the 55 percent thereof payable to individuals was therefore available as a deduction to the trust under Section 162 (b) of the Internal Revenue Code, which allows a deduction to a trust of the income for the taxable year which is to be distributed currently to beneficiaries, provided that the amount allowed as a deduction is included in computing the net income of the beneficiaries, whether distributed to them or not. The 45 percent of the $240,567.73 which was set aside for Surdna Foundation was allowable as a deduction to the trust under Section 162 (a), rather than Section 162 (b). See *Grey* v. *Commissioner*, 41 B. T. A. 234, affirmed, 118 F. 2d 153 (C. A. 7th).

[3] The capital gain was evidently not considered as currently distributable income but as an addition to corpus for purposes of administering the trust. Cf. *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509; *In re Rogers' Estate*, 143 F. 2d 695, 696 (C. A. 2d), certiorari denied, 323 U. S. 780. Because the 55 percent of the gain which ultimately will be distributed to individuals on termination of the trust was not currently dis-

of had been held for more than six months, only one-half, or $30,187.01, was to be taken into account under Section 117 (b) of the Internal Revenue Code (Appendix, *infra*, p. 46) in computing taxable net income. This gross figure was reduced by a 1942 carry-over of $329.60,[4] leaving a balance of $29,857.41 which was taken into account as income. There was permanently set aside for the Foundation 45 percent of the total

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tributed or distributable, the trust was not entitled to a deduction under Section 162 (b) or (c) in respect of it. Since 45 percent of the gain was permanently set aside to be distributed ultimately to charity, the trust may however have a deduction in some amount in respect of it under Section 162 (a). See G. C. M. 423, V-2 Cum. Bull. 53 (1926); G. C. M. 10423, XI-2 Cum. Bull. 127 (1932); cf. *Bowers* v. *Slocum*, 20 F. 2d 350 (C. A. 2d). The question here presented, whether the deduction may be of the total capital gain or only the taxable portion thereof set aside for charity, did not arise in the cited authorities because they involved taxable years occurring prior to the enactment of the Revenue Act of 1934, c. 277, 48 Stat. 680, which inaugurated the system of taxing only a percentage of the capital gain depending on the length of time the asset disposed of had been held. See infra, pp. 19-21. The findings in *Commissioner* v. *F. G. Bonfils Trust*, 115 F. 2d 788 (C. A. 10th), affirming 40 B. T. A. 1085 (see also *Bonfils, Exrs.* v. *Commissioner*, 40 B. T. A. 1079), do not show whether the question in this case may have been present there, but if it did lurk in the case it was not raised or decided.

[4] The trust's 1944 return, which was an exhibit in the case before the Court of Claims, showed that this was a capital loss carried over from 1942. Section 117 (e) of the Internal Revenue Code (Appendix, *infra*, pp. 47-48) authorizes the carry-over of a capital loss for one year to reduce the capital gains of succeeding years in some circumstances.

capital gain of $60,374.01, or $27,168.31, and the Court of Claims held that under Section 162 (a) the taxpayer is entitled to deduct the full amount of $27,168.31 set aside.

It is the Government's position that this decision is erroneous and that the trust is entitled, under Section 162 (a), to deduct only that part of the capital gain permanently set aside for Surdna Foundation which constituted taxable income. This view makes full allowance taxwise for monies set aside by the trust for charitable purposes since one-half of the amount in question is excluded from gross income leaving only the other half to be deducted under Section 162(a). Here, the trusts allowable deduction under Section 162(a) would be $13,435.83, representing 45 percent of the taxable capital gain of $29,857.41. In support of this position, we shall show (A) that only 50 percent of the capital gain constituted "gross income" within the meaning of Section 22 (a) of the Internal Revenue Code; (B) that only that part of the gain, in any event, constituted gross income for purposes of Section 162 (a); and (C) that the trust's allowable deduction under Section 162 (a) is 45 per cent of the taxable portion of the capital gain.

A. Only the taxable portion of a capital gain constitutes gross income under Section 22(a)

1. *The statutory provisions.*—It has been held that in allowing a deduction for the part of the "gross income" which, pursuant to the terms of

the will, is permanently set aside for charity, Section 162 (a) refers to the statutory gross income for tax purposes, or gross income within the purport of Section 22 (a) of the Code. The Court of Claims so thought in this case (R. 8), and this view accords with that of other courts. *Commissioner* v. *Central Hanover B. & T. Co.*, 163 F. 2d 208 (C.A. 2d), certiorari denied, *sub nom. Trust of Andrus* v. *Commissioner*, 332 U.S. 830; *Frank Trust of 1931* v. *Commissioner*, 145 F. 2d 411 (C.A. 3d). For present purposes, it will be assumed that gross income under Sections 22 (a) and 162 (a) is the same.

Section 22 (a) of the Code (Appendix, *infra*, p. 40) includes in gross income *inter alia* gains from dealings in property, but it does not specify how the gain from sale or other disposition of property which is includible in gross income shall be determined or measured. Hence it is obvious that Section 22 (a) alone is not a complete definition in so far as such gains are concerned and that other sections must be examined to determine the gain which will constitute gross income. Indeed, Section 22 (f) (Appendix, *infra*, p. 40) provides that in the case of a sale or other disposition of property, the gain or loss shall be computed as provided in Section 111.

Section 111 (a) of the Code (Appendix, *infra*, p. 43) provides that the gain from sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted

basis provided in Section 113 (b), and Section 111 (c) (Appendix, *infra*, pp. 43-44) provides that the extent to which a gain so determined shall be recognized shall be determined under the provisions of Section 112. Where a gain is not recognized under Section 112, it does not constitute "gross income" under Section 22 (a). 3 Mertens, *Law of Federal Income Taxation*, Sec. 20.01, p. 81. And this is so, even though it is a "gain" as computed under Section 111.

Sections 111 and 112 deal generally with all types of gains and losses, ordinary as well as capital, but they are not complete in so far as capital gains and losses are concerned. In the case of capital assets, after the excess of the amount realized over the adjusted basis has been determined under Section 111 and the gain so determined has been ascertained to be a recognized gain under Section 112, it is still necessary to look to Section 117 to find the portion of the capital gain which is to be "taken into account" and so is the ultimate measure of gross income includible under Section 22 (a).

Section 117 (b) provides that only 50 percent of the gain or loss on sale or exchange of a capital asset shall be taken into account in computing "net" income if the capital asset has been held for more than six months.[5] This section does not

[5] All of the capital gain ($60,374.01) involved in this case was derived from the sale of assets which had been held for more than six months. (R. 8.)

explicitly point to the effect on gross income of its provisions, but an analysis of the general plan of the Code makes it clear that capital gains, not taken into account under Section 117 (b), cannot be included in gross income.

Under Section 21 (a) of the Code (Appendix, *infra*, p. 40) "net income" means the gross income computed under Section 22, less the deductions allowed by Section 23. If, as the Court of Claims held, the entire long-term capital gain constitutes gross income under Section 22 (a), then there should be found some provision in the statute under which the nontaxable portion of the gain is deductible or excludible. But Section 23 contains nothing to authorize a deduction for the part of a capital gain which is not to be taken into account. Section 117 (b) does not itself purport to grant a deduction from gross income. And although Sections 22 (b) and 116 enumerate items which are to be excluded from gross income, neither makes any mention of capital gains. As a result, unless the part of the gain not taken into account pursuant to Section 117 (b) is regarded as excluded from gross income by that section, the computation of net income as provided in Section

21 (a), which Section 117 (b) plainly refers to, would not eliminate the nontaxable capital gain. The only way in which net income can be computed under the statutory plan of Sections 21, 22, and 23, to reflect only the 50 percent of the long-term capital gain to be taken into account, is to include only that 50 percent in gross income.

Section 117 (b) does not itself direct how the net income of a taxpayer is to be calculated. It prescribes only that specified percentages of gain or loss are to be taken into account "in computing net income." The necessary conclusion is that net income is to be computed as provided in Sections 21-23, already discussed, and that Section 117(b) was not intended to oust or replace Sec-

tions 21-23. Cf. *White* v. *United States,* 305 U. S. 281, where it was pointed out (pp. 286-287) that the capital gains and loss section (101) of the Revenue Act of 1928 was supplementary[6] to Sections 21, 22, and 23, which governed the computation of net income. The view that Section 117 (b) was intended to fit into the plan for computation of net income in Sections 21-23 is further emphasized by the fact that while Section 23 contains no provision for deducting the portion of gain not taken into account, Section 23 (g)(1) (Appendix, *infra,* p. 41) provides that capital losses are to be deducted "only to the extent provided in section 117." Section 23 (g)(1) is thus the specific authority for deduction of a capital loss, not Section 117 (b). Section 23 (g) (1) would be superfluous if Section 117 (b) itself authorized deduction of a capital loss in computing net income. Such redundancy is not to be implied.

Thus, it is evident that Section 117 (b) fits precisely into the pattern of Sections 21-23. Where there is a gain, there is no need for an exclusion or deduction since the portion not taken into account is never reflected in gross income. But where there is a capital loss, a specific authority for deduction of the loss, as found in Section 23 (g)(1), is necessary in order that net income may

[6] Section 117 (b) of the Code is still supplementary. It is contained in Supplement B to Chapter 1, imposing the income tax, of which Sections 21-23 are a part.

be reduced. That is to say, the mandate of Section 117 (b), that only specified percentages of a capital gain or loss "shall be taken into account in computing * * * net income" is followed when capital gains are taken into account by including them *in* gross income, and capital losses are taken into account by deducting them *from* gross income after it has been computed.

It is no answer to this analysis that Congress, in Section 117 (b), used the phrase "net income" and not "gross income". For Congress, in that section, was dealing not only with gains but also with losses; and a loss is not taken into account, as has been shown, in the computation of gross income. Congress chose to deal with both gains and losses together in Section 117 (b), and the language used must be appraised in that light. Its precise and necessary meaning in respect of gains alone appears by consideration of the fact that, "in computing * * * net income", gains can be taken into account only by including them in gross income. It must follow, we submit, that only 50 percent of a long-term capital gain represents gross income under the language of Section 117 (b).

The correctness of this conclusion is underlined by the fact that Section 22 (a) defines gross income as including "gains * * * derived from * * * sales, or dealings in property", and Section 117 (a) (4) states that—

> The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income:[7]

By Congressional direction, therefore, a taxpayer is regarded as having a capital gain for tax purposes only to the extent it is "taken into account" in computing net income. The effect of this definition is to permit a taxpayer to ignore the portion of the gain not taken into account and thus not to treat it as gross income within the purview of Section 22 (a). It should be noted that the definitions are stated to be for use in the whole income tax chapter, not merely Section 117.

Finally, Section 117 (c) (2) of the Code (Appendix, *infra*, p. 47) provides, in certain circumstances, for a tax in lieu of the ordinary normal tax and surtax.[8] This alternative method may be used only if it results in a lesser tax than would otherwise result and, it follows, that the two taxes must be computed on the same base, that is,

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[7] Similar definitions are found in Section 117 (a)(2), (3), and (5) for short-term capital gain, short-term capital loss, and long-term capital loss.

[8] The normal tax and surtax is imposed by Sections 11 and 12. Under those sections the net gain to be taken into account is included in gross income along with other items of taxable income, the allowable deductions are subtracted therefrom to arrive at net income, and the normal tax and surtax imposed by Sections 11 and 12 on individuals are computed on the net income so determined.

on the same income. It is quite significant, then, that the alternative method prescribed includes in income only such capital gains as are "taken into account" under Section 117 (b). It does so in this fashion: A partial tax on the net income, reduced by the excess of the "net long-term capital gain" over the "net short-term capital loss" is first computed at the rates provided in Sections 11 and 12. There is then added to this partial tax a tax of 50 percent of the excess. The amount of this excess is determined by reference to the definition provisions of Section 117 (a) (Appendix, *infra*, pp. 44-46), and these, in turn, limit capital gains and losses to the amount "taken into account in computing net income." See Sections 117 (a) (2)-(5). In the case of a long-term capital gain, the amount taken into account, as we have seen, is only 50 per centum. Section 117 (b), Appendix, *infra*, p. 46). Thus, 50 per cent of the long-term gain is all that ever enters into the computation of the alternative tax and there is no reason whatever to believe that a greater amount is included in gross income when the tax is computed under Sections 11 and 12.

2. *The legislative history.*—The legislative history of Section 117 confirms the conclusion that a taxpayer's gross income includes only the portion of a capital gain which is taken into account. Although capital gains and losses have been specially treated since the Revenue Act of 1921, the system

of taxing capital gains and losses by taking only a specified portion of the gain or loss into account, depending on the length of time the asset had been held, dates from the adoption of Section 117 of the Revenue Act of 1934, c. 277, 48 Stat. 680.[9] In explaining the new provision, H. Rep. No. 704, 73d Cong., 2d Sess., p. 10 (1939-1 Cum. Bull. (Part 2) 554, 562), stated:

> First. To measure the gain or loss from the sale of property by an individual according to the length of time he has held the property, only the following percentages of the recognized gain or loss are taken into account for tax purposes: * * *

This shows, we believe, that it was intended that the measure of the gain realized was to be the percentage of gain taken into account. In other words, for tax purposes, statutory gain under Section 22 (a) consisted of the portion of the actual gain taken into account. This intention is made even clearer in the same committee report. After giving a specific example in which the capital gains were $8,000, the capital losses were $7,000, and the capital gains and losses to be taken into account under the percentages then applicable were $7,600 and $4,400, respectively, H. Rep. No. 704, *supra,*

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[9] The percentages and the holding periods have not remained the same in the various Revenue Acts since that Act and in the Internal Revenue Code, but the method of taxing a percentage of capital gains and losses according to the period held has not been changed.

pp. 31-32 (1939-1 Cum. Bull. (Part 2) 554, 578), stated:

> In the above case, the *taxpayer would include in gross income subject to tax* $7,600 in gains and be allowed to deduct $4,400 of losses. The net increase in his income will, therefore, be $3,200. * * * (Italics supplied.)

Thus, it is apparent that the Committee intended that gross income would include only the portion of the total gain which was taken into account under Section 117.[10] And ten years later, in recommending a technical amendment to Section 117 to conform it to the new definition of "adjusted gross income" in the bill which became the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231, Sec. 8, the Senate Finance Committee stated (S. Rep. No. 885, 78th Cong., 2d Sess., p. 26 (1944 Cum. Bull. 858, 879)):

> Of course, the same percentages of gain or loss taken into account in computing net income under section 117 (b) *are taken into account in determining gross income,* and, therefore, in computing adjusted gross income. (Italics supplied.)

3. *The administrative construction.*—The administrative construction of the statute, as re-

[10] S. Rep. No. 558, 73d Cong., 2d Sess., pp. 11-13 (1939-1 Cum. Bull. (Part 2) 586, 594-596), indicates no disagreement with this basic understanding of the legislation.

flected in the tax return forms,[11] has been in accord with the interpretation here urged. The fiduciary return of the sort filed by the taxpayer in this case (bound in at the back of this brief) provides, in Schedule E, for the reporting of the following data for assets held for more than six months: A description of the property, the date acquired, the date sold, the gross sales price, the basis, the expense of sale, the depreciation theretofore allowed, and the resulting gain or loss. Fifty percent of the gain or loss so determined is then entered in column 10 which is designated the net long-term capital gain or loss. The net long-term gain (less a capital loss carry-over if any) shown in Schedule E is carried over and entered as item 7 (a) on page one of the return under the heading "income." From the total income, amounts are subtracted pursuant to the various deductions allowed by law, and the net income is thus arrived at. On the return form actually used and followed by the taxpayer in reporting the gain involved in this case, therefore, although the total gain was computed in a schedule, attached to the return, only the 50 percent of long-term capital gain taken into account under Section 117 (b) was

[11] Section 29.117-2(a) of Treasury Regulations 111 (Appendix, *infra*, pp. 51-52) merely repeats the statutory language and is not presently helpful. However, the first example contained in Section 29.162-2 of Treasury Regulations III shows very clearly the Treasury interpretation of the statute, namely, that the percentage of long-term capital gain which is not to be taken into account under Section 117(b) is an item which is not includible in gross income.

included as an item of taxable gross income. The return forms for both individuals and estates and trusts from 1934[12] up to and including the year 1943-1944 which is in issue here, and indeed even to the present time, have consistently required the inclusion in taxable gross income of only the percentage of capital gain taken into account. See return forms printed in C.C.H. and P-H Federal Tax Services.[13] See also *Maloy* v. *Commissioner*, 45 B.T.A. 1104, 1107, in which the Board of Tax Appeals (now the Tax Court) referred to the fact that, on the return form for 1935, only the part of the capital gain taken into account under Section 117 (b) was treated as gross income.

The administrative position was also stated in 1939 in G.C.M. 21432, 1939-2 Cum. Bull. 234, which considered the proper computation of the foreign tax credit allowed by Section 131 of the Revenue Act of 1934 in connection with a capital gain. The

[12] As was pointed out, *supra*, pp. 19-20, the system of taxing only a part of the capital gain, depending on the length of time the asset disposed of had been held, originated in the Revenue Act of 1934.

[13] C. C. H. Federal Tax Service for 1935, pp. 16113-16114, 16133-16134; 1936, pp. 16096-16097, 16102-16103; 1937, pp. 16091-16092, 16097-16098; 1938, pp. 16110-16113, 16122-16123; 1939, pp. 228-231, 16060-16062; 1940, pp. 16070-16073, 16088-16091; 1941, pp. 16035-16038, 16053-16056; 1942, pp. 16031-16034, 16049-16052; 1943, pp. 16031-16034, 16054-16057. The return forms have consistently so treated capital gains even down to the present time. See P-H Federal Tax Service for 1945, pp. 18763-18766, 18794-18797 (1944 returns), 18841-18848, 18861 (1945 returns); 1947, pp. 18785-18789, 18795-18798 (1946 returns); 1948, pp. 18785-18789, 18800-18803 (1947 returns); and 1949, pp. 18810-18819 (1948 returns).

entire gain was taxed by the foreign government, but only a percentage thereof (30 percent) by the United States. In limiting the credit to an amount computed on the taxable portion of the gain, the ruling stated (p. 236):

> From the foregoing precedents, it is evident that under the Revenue Act of 1934 if the income taken into account under section 117 (a) is limited to 30 per cent of the actual income, the remaining 70 per cent of the profit from the transaction *is excluded entirely from gross income* and, therefore, forms no part of the net income upon which the United States tax is computed. * * * (Italics supplied.)[14]

The administrative construction of Section 117 (b), as reflected consistently for almost ten years prior to the taxpayer's fiscal year, and since that time, in the widely distributed and public tax return forms, has, under well established principles, received the implied approval of Congress, since the statute was reenacted and amended several times during the interval without significant change in this respect. *Crane* v. *Commissioner,* 331 U.S. 1; *Helvering* v. *Wilshire Oil Co.,* 308 U.S. 90; *Helvering* v. *Winmill,* 305 U.S. 79. See *Estate of Sanford* v. *Commissioner,* 308 U.S. 39, 52-54, rehearing denied, 308 U.S. 637; *Helvering* v. *Bliss,* 293 U.S. 144; cf. *Brewster* v. *Gage,* 280 U.S. 327.

[14] G.C.M. 21432 was modified by G.C.M. 25723, 1948-2 Cum. Bull. 131, in so far as the method of computing the foreign tax credit is concerned, but the statement quoted above was not modified or withdrawn.

It seems indisputable that the administrative practice in this regard carries out the intention of Congress, as expressed in Section 117 (a) and (b) and the legislative statement already discussed. But if, contrary to our firm conviction, Section 117 (b) were regarded as not entirely clear on the question of whether the capital gain taken into account is to be the measure of gross income or only of net income, the administrative interpretation which has implied legislative approval should be controlling. This is especially true here, because in Section 117 (a) of the Revenue Act of 1938, Congress enacted the definitions of long and short-term capital gains and losses, which are in harmony with the administrative construction.

4. *The cases.—Commissioner* v. *Central Hanover B. & T. Co.*, 163 F. 2d 208 (C.A. 2d), certiorari denied, *sub nom. Trust of Andrus* v. *Commissioner*, 332 U.S. 830, presented the precise question that is involved in this case in connection with a long-term capital gain realized by an *inter vivos* trust created by the decedent here, which directed the payment of 45 percent of the income, and of the corpus on termination of the trust, to the Surdna Foundation. The Second Circuit, relying on the definitions in Section 117 (a), decided that (p. 210) "the amount of long-term capital gain not taken into account under §117 does not constitute gross income of the trust under §22 (a)." The decision is of course squarely contrary to that of the

Court of Claims in this case[15] and we submit that it reaches the correct conclusion under the statutory provisions, the legislative history, and the approved administrative construction previously discussed.

Also, in *Wellman* v. *Welch*, 99 F. 2d 75 (C.A. 1st), the court stated (p. 76), although no issue with respect to it appears to have been raised, that the estate's *gross taxable income* consisted of interest, dividends, and "capital gain on the sale of capital assets to the extent of 80 percent thereof, $114,790.86." This is a clear recognition that gross income resulted only to the extent the gain was taken into account under Section 117 of the Revenue Act of 1934.

The view that only the capital gain taken into account for tax purposes constitutes gross income is further supported by *Maloy* v. *Commissioner*, 45 B.T.A. 1104. The issue there was whether the entire amount of capital gain constituted gross income within Section 275 (c) of the Revenue Act of 1934, which provides a five year statute of limitations for assessment of a tax if a taxpayer has

[15] The *Central Hanover* case involved the year 1941. Section 117 (b) of the Code then provided that 50 per cent, 66 2/3 percent, and 100 percent, respectively, of the gain or loss upon sale of capital assets should be taken into account, depending upon whether the capital asset had been held for more than 24 months, for between 18 and 24 months, or for less than 18 months. The different percentages and holding periods, however, do not affect the fact that the same basic question was involved and decided in both cases.

omitted from his return gross income properly includible therein which is in excess of 25 percent of the amount stated in the return. The Board of Tax Appeals, holding that only the capital gain taken into account was gross income, said (p. 1107):

> We agree with petitioner. We think it evident that the term "gross income" as used in section 275 (c), *supra*, refers to the statutory gross income required to be reported on the return. The heading, "Gross Income", on the form of the return calls for the inclusion there only of gross taxable income. That amount does not include that portion of capital gain which is not to be taken into account in computing taxable income, nor does it include non-taxable interest on Government securities. Section 275 (c) refers to the omission from gross income of an amount "properly includible therein", which manifestly does not cover the non-taxable portion of the capital gain realized by the trusts, * * *.

The gross income to be included in the return within the meaning of Section 275 (c) of course corresponds to gross income as defined by Section 22 (a). It has a specific meaning "denoting statutory gross income defined by section 22." *Green* v. *Commissioner,* 7 T.C. 263, 277. Thus the *Maloy* decision is directly pertinent here, where the issue is whether the part of a capital gain not taken into

account constitutes gross income under Section 22 (a).[16]

In *Green* v. *Commissioner, supra,* the Tax Court held that gross income under Section 275 (c) must be computed without regard to net long-term capital losses; there it was pointed out that Section 23 (g)(1), in providing that such losses must be deducted from gross income to arrive at net income, negates the assumption that such losses are to diminish the gross income which is reportable as such. As already shown, the lack of a corresponding deduction with respect to the capital gain not taken into account can only mean that such gain never becomes part of gross income.

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[16] *Lockhart* v. *Commissioner,* 1 T.C. 804, which the Court of Claims cited, does not necessarily reach an inconsistent result. There the question concerned the amount of gain on satisfaction of unpaid installment obligations. This in turn depended on the basis of the obligation, which Section 44 (d) of the Internal Revenue Code defined as "the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full." The Tax Court held that the income from capital gain which would be returnable, i.e., reportable on the return, was the entire amount of the gain. As already shown, the entire gain is required to be reported on a schedule of the return, but only the specified percentage of the gain to be taken into account is entered as an item of gross income on the return. The Tax Court's decision that the entire gain is "returnable" must be understood in this setting. The Tax Court was not concerned with the question of whether the entire gain constituted gross income, although some of the statements in the opinion may imply that, in its view, that would be so.

B. Only the taxable portion of a capital gain constitutes "gross income" as that term is used in Section 162(a)

Section 162 (a) of the Internal Revenue Code allows as a deduction "any part of the gross income, without limitation" which is paid or set aside for charitable purposes. Appendix, *infra*, p. 49. Up to this point in the argument, it has been assumed that the term "gross income" as used in Section 162 (a) is synonymous with "gross income" under Section 22 (a). However, there are compelling reasons for construing "gross income" in Section 162 (a) as including only the taxable portion of a capital gain, whether the entire gain or only the part to be taken into account, is regarded as gross income under Section 22 (a).

First, the denial of a deduction under Section 162 (a) with respect to the nontaxable portion of the capital gain set aside for charity would fulfill the Congressional purposes in respect of Sections 161 and 162 as a whole, whereas the decision of the Court of Claims does not. It was Congress' intention that all of the income received by an estate or trust, which is held for, or is distributable to, noncharitable beneficiaries, is to be taxed either to the estate or trust or to the beneficiaries. Under the provisions of Sections 161 and 162 (b) and (c), the income is taxable to the estate or trust if it is not paid or credited and is not currently distributable to the beneficiaries, and the income is taxable to the beneficiaries if currently distributable or properly paid or credited to them, the trust being

entitled to deduct such income. See *Freuler* v. *Helvering,* 291 U.S. 35, 41-42. As was said in *Helvering* v. *Butterworth,* 290 U.S. 365, 369:

> The evident general purpose of the statute was to tax in some way the whole income of all trust estates. If nothing was payable to beneficiaries, the income without deduction was assessable to the fiduciary. But he was entitled to credit for any sum paid to a beneficiary within the intendment of that word, and this amount then became taxable to the beneficiary. Certainly, Congress did not intend any income from a trust should escape taxation unless definitely exempted.

Thus, the 55 percent of the capital gain which will ultimately be distributed to the individual beneficiaries of the testamentary trust in this case was intended to be taxable to the trust since it was not currently distributable and was not distributed. Yet to adopt the decision of the Court of Claims here results in the escape from tax of part of the 55 per cent of the capital gain which is accumulated for ultimate distribution to noncharitable beneficiaries, contrary to the recognized purpose of Sections 161 and 162 (b) and (c). For if the trust is permitted to deduct the entire 45 percent of the capital gain set aside for charity, only one-half of which constituted taxable income, the result is that one-half of the deduction applies, properly, to free the one-half of the charitable gift from tax, while the other half of the deduction ap-

plies to reduce *pro tanto* the taxable one-half of the 55 percent of the gain distributable on termination of the trust to private beneficiaries. Thus, part of the income which was intended to be taxed to the trust escapes tax.[17]

Section 162 (a) was certainly not intended to accomplish this, and thus to frustrate in part Sections 161 and 162 (b) and (c). Its obvious purpose was only to exempt from tax such part of the gross income as was permanently set aside for, or paid to, charity. See *Bowers v. Slocum*, 20 F. 2d 350, 352 (C.A. 2d). That purpose is served when the trust deducts the part of its *taxable* gross income set aside for charity, since it then is not taxable on any part of the charitable gift. And as shown, to enlarge the deduction to cover nontax-

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[17] The precise figures involved are as follows: The trust had income from the long-term capital gain of $60,374.01, of which $27,168.31 was set aside for Surdna Foundation. Only $29,857.41 of the gain (after deducting the loss carry-over) was taxable income to the trust under Section 117 (b). When the entire amount of $27,168.31 set aside for charity is deducted, there remains only $2,689.10 of net income taxable to the trust, despite the fact that of the $29,857.41 gain taken into account in computing income, only $13,435.83 was held for charity and $16,421.58 was held for future distribution to taxable beneficiaries. The trust was clearly intended to be taxed on the $16,421.58 just as clearly as it was not intended to be taxable on the $13,435.83 gift to charity. The decision of the Court of Claims however, through the deduction of $27,168.31 instead of $13,435.83, reduces the trust's income from $16,421.58, to $2,689.10. Thus, $13,732.48 of the income, held for taxable beneficiaries and intended to be taxed to the trust, escapes tax.

able income set aside for charity results in defeating Sections 161 and 162 (b) and (c) in part, since it frees from tax other income intended by those sections to be taxable either to the trust or the beneficiaries. There is certainly no reason to construe Section 162 (a) as giving the trust in this case a windfall of that kind, when the purpose of Section 162 (a) is fully served if all of the taxable capital gain set aside for charity is exempted from tax by way of a deduction. We submit that Section 162 (a) should be construed as permitting a deduction only of the taxable part of a capital gain set aside for charity, in order that Sections 161 and 162 (b) and (c) may operate as they were intended.

That Section 162 (a) should not be construed to authorize a deduction of the nontaxable portion of a capital gain held for charity is also forcefully highlighted by the fact that to do so would permit the equivalent of a double deduction. That is, there would be an exclusion from income under Section 117 (b) of one-half of the gain set aside for charity and then a deduction from taxable income (including that held for distribution to noncharitable beneficiaries) of the entire gain so set aside, including a deduction of the one-half of the gain already excluded from income. It is a well established rule that, in the absence of explicit Congressional authority, double deductions or their equivalent are not to be permitted. *Ilfeld Co. v. Hernandez*, 292 U.S. 62; *McLaughlin* v. *Pacific*

Lumber Co., 293 U.S. 351; *United States* v. *Ludey*, 274 U.S. 295. The general policy against double benefits through deduction and exclusion of the same item should dictate that Section 162 (a) is to be construed so as to avoid the giving of the equivalent of a double deduction. And especially so, since Section 24 (a)(5) of the Internal Revenue Code (Appendix, *infra*, p. 43) expressly withholds the right in any case to a deduction which is allowable under any other section in so far as it is attributable to income wholly exempt from tax. As Section 29.24-4 of Treasury Regulations 111 (Appendix, *infra*, pp. 50-51) points out, the object of Section 24 (a)(5) is to prevent a double exemption from tax arising through the exclusion of an item from income and a deduction from other income of items allocable to the exempt income. This statutory version of the rule against a double tax benefit through deduction and exemption of the same item admonishes most strongly against a construction of Section 162 (a) which would permit that result.[18]

Even if the matter were less clear than we believe it to be, the principle that a provision exempt-

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[18] Section 24 (a)(5) is merely one example, expressed in general terms, of the Congressional policy not to allow deductions for amounts allocable or attributable to exempt or nontaxable income. See, e.g., Sections 125 (a)(2), 211 (c)(2), 213 (a) and (c), 232 (a), and 251 (e) of the Internal Revenue Code. The consistent policy in this respect plainly fortifies the correctness of our position here.

ing income devoted to charity is not to be narrowly construed (*Helvering* v. *Bliss,* 293 U. S. 144, 150-151; *United States* v. *Pleasants,* 305 U. S. 357, 363)[10] does not in the circumstances here support a construction of Section 162 (a), which would allow a deduction for the entire capital gain set aside for charity. The object of granting the deduction for charitable gifts under Section 162 (a) was obviously to encourage such gifts by exempting the income given to charity from tax. *Helvering* v. *Bliss, supra,* pp. 150-151; *Bowers* v. *Slocum,* 20 F. 2d 350, 352 (C.A. 2d). As already shown, this purpose is served when half the long-term capital gain is excluded from gross income and deduction is had for the other half—the taxable income given to charity. In this way, at the same time, the purpose of Sections 161 and 162 (b) and (c) to tax the income held for other beneficiaries is also fulfilled. A broader construction, that is, the allowance of a larger deduction than is necessary to accomplish the purpose of exempting charitable gifts from tax is certainly not warranted, especially where to do so will frustrate the operation of other sections and will result in allowing the taxpayer the equivalent of a double deduction. Such considerations were not present in the

[10] The *Bliss* and *Pleasants* cases were concerned with the amount of the deduction for charitable contributions under predecessors of the present Section 23 (o). The statutory provisions relating to capital gains and losses which they considered were materially different from those involved here.

Bliss and *Pleasants* cases. In this connection, cf. *Taft* v. *Commissioner,* 304 U.S. 351, 359, and *Harrison* v. *Northern Trust Co.,* 317 U.S. 476, 480-481, which indicate that the principle of a broad construction, as applied to deductions for gifts to charity, is not without limitation. It may be observed here that Section 162 (a), of course, does not grant an unlimited deduction for all gifts to charity, since gifts of corpus are excluded by its terms. The deduction is for the purpose of ascertaining a trust's taxable net income and because of this it seems necessary to impute an intention to exclude items which do not enter into taxable income.

C. The taxpayer's allowable deduction under Section 162(a) is 45 per cent of the taxable portion of the capital gain

We have sought to show that only 50 per cent of the capital gain of the trust in this case constituted gross income under Section 22 (a) or, in any event, within the meaning of that term as used in Section 162 (a). If either of these arguments is accepted, it follows that the trust's deduction under Section 162 (a), which grants a deduction for only such part of the gross income as is permanently set aside for charity, is 45 per cent of the 50 per cent of the gain (less the loss carry-over), which is gross income, or $13,435.83. See *Commissioner* v. *Central Hanover B. & T. Co.,* 163 F. 2d 208 (C.A. 2d), certiorari denied, *sub nom.* *Trust of Andrus* v. *Com-*

missioner, 332 U. S. 830, which decided that the deduction under Section 162 (a) must be limited to the part of the charitable gift made out of statutory gross income.

The Court of Claims in this case rejected the conclusion set forth above on the ground that it resulted in allowing the taxpayer a deduction under Section 162 (a) of only the "net income", instead of the gross income, set aside for charity. (R. 9, 11.) This view, of course, is not accurate if only the capital gain taken into account constitutes gross income, since the deduction of $13,435.83 to which the taxpayer is concededly entitled would be a deduction for all of the gift to charity which came from "gross income."

Nor does the position of the Government fail to give effect to the language "gross income, without limitation" used in Section 162 (a). If only the gain taken into account constitutes gross income, the taxpayer will be allowed a deduction for the full amount of such gain set aside for charity and thus of its entire gross income so set aside without limitation.

In any case, it seems clear that the words "without limitation" have the purpose only of removing for estates and trusts the 15 per cent of net income limitation imposed by Section 23 (o) of the Code (Appendix, *infra,* pp. 41-42) on the deduction by individuals of charitable contributions. *Commissioner* v. *Central Hanover B. & T. Co., supra,* p.

211; *Grey* v. *Commissioner,* 41 B.T.A. 234, 243, affirmed, 118 F. 2d 153 (C.A. 7th), and *Scott* v. *United States,* 78 F. Supp. 811, 815-816 (C. Cls.), so held. As was pointed out in *Grey* v. *Commissioner,* p. 243, this is obvious from the parenthetical matter in Section 162 (a) (Appendix, *infra,* p. 49) that the deduction is in lieu of that allowed by Section 23 (o).

The legislative history of the phrase "without limitation" moreover, supports this view.

In the Revenue Act of 1913, c. 16, 38 Stat. 166, and the Revenue Act of 1916, c. 463, 39 Stat. 756, there was no provision for the deduction by individuals of gifts to charities in computing their net incomes, nor was there any exemption or deduction in favor of income accumulated in a trust fund which was not to be distributed annually or regularly even though such income was to go ultimately to a charity. Section 1201(2) of the Act of October 3, 1917, c. 63, 40 Stat. 300, amended the Revenue Act of 1916 by adding a provision for the deduction by individuals of charitable contributions to an amount not in excess of 15 percent of the taxpayer's taxable net income. In paragraph (11) of Section 214(a) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, the provision was continued for the deduction of charitable gifts by individuals up to 15 percent of their total net incomes. Subdivision (a) of Section 219 of that Act imposed upon the income of trust estates and income held for fu-

ture distribution under the terms of a will or trust, the same taxes which the Act imposed upon the income of individuals, and subdivision (b) of Section 219 provided:

> The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that there shall also be allowed as a deduction (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of Section 214) any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for * * * any corporation organized and operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the earnings of which inures to the benefit of any private stockholder or individual; * * *

The words "without limitation" first appeared in Section 219(b) of the Revenue Act of 1921, c. 136, 42 Stat. 227, which provided—

> * * * The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of Section 214) there shall also be allowed as a deduction, without limitation, any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside

> for the purposes and in the manner specified in paragraph (11) of subdivision (a) of section 214. * * *

This change, together with other changes in the 1921 Act, had been embraced within Section 225 of the House Bill and the changes were explained in H. Rep. No. 350, 67th Cong., 1st Sess., p. 12 (1939-1 Cum. Bull. (Part 2) 177) as follows:

> Section 225 removes certain obscurities in existing law relating to the income of estates or property held in trust by explicitly adopting the construction which has uniformly been given to this section of the law by the Treasury Department.

The provision in question was included in Section 219 of the bill as reported to the Senate, and was explained in S. Rep. No. 275, 67th Cong., 1st Sess., p. 16 (1939-1 Cum. Bull. (Part 2) 192) as follows:

> Section 219 is amended slightly for the purpose of clarifying its provisions and making the interpretation thereof more definite and certain.

It is apparent, we submit, that the only plausible explanation for the insertion of the words "without limitation" was to make certain that the deduction given to trusts in lieu of the deduction allowed individuals for charitable contributions was to be without the 15 percent limitation which applied to charitable gifts by individuals.

In Section 219(b) of the Revenue Act of 1924, c. 234, 43 Stat. 253, the parenthetical language "(in lieu of the deduction authorized by paragraph (10) [paragraph (11) of the Revenue Act of 1921] of subdivision (a) of section 214)" was shifted to follow the word "deduction" and the phrase "without limitation" was shifted to follow the words "gross income" instead of following the word "deduction". The statute has continued in that form in all subsequent acts. This change in the position of the words "without limitation" was apparently not regarded as having any significance since it was not discussed in the committee reports. H. Rep. No. 179, 68th Cong., 1st Sess., p. 21 (1939-1 Cum. Bull. (Part 2) 241, 256); S. Rep. No. 398, 68th Cong., 1st Sess., p. 25 (1939-1 Cum. Bull. (Part 2) 266, 283.) See *Grey* v. *Commissioner, supra,* p. 243. Cf. *Old Colony Co.* v. *Commissioner,* 301 U.S. 379, 382-383.

Under the view here advanced, the taxpayer is given the full benefit by way of deduction of the entire part of the gain set aside for charity. This results from the exclusion from gross income of one-half of the charitable gift under Section 117 (b) and the deduction under Section 162 (a) of the other half of the charitable gift. The allowance of a deduction of one-half of the portion of the gain set aside for charity is, we believe, the correct deduction under the statutory provisions discussed above, since only one-half of the gain constitutes gross income.

CONCLUSION

The judgment of the Court of Claims should be reversed.

Respectfully submitted,

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September, 1949.

Internal Revenue Code:

SEC. 21. NET INCOME.

(a) *Definition.*—"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

* * * * * *

(26 U.S.C. 21.)

SEC. 22. GROSS INCOME.

(a) [As amended by the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574, Sec. 1] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions From Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * * *

(f) *Determination Of Gain Or Loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

* * * * * *

(26 U.S.C. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

*   *   *   *   *   *

(g) *Capital Losses.*—

(1) *Limitation.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

*   *   *   *   *   *

(o) [As amended by the Revenue Act of 1939, c. 247, 53 Stat. 862, Sec. 224 (a), and the Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 127 (c)] *Charitable and Other Contributions.*—In the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of:

(1) The United States, any State, Territory, or any political subdivision thereof or the District of Columbia, or any possession of the United States, for exclusively public purposes;

(2) A corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any possession thereof or under the law of the United States or of any State or Territory or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private share-

holder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

(3) the special fund for vocational rehabilitation authorized by section 12 of the World War Veterans' Act, 1924, 43 Stat. 611 (U.S.C., Title 38, §440);

(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) a domestic fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals;

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection or of subsection (x). Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * * *

(26 U.S.C. 23.)

Sec. 24. Items Not Deductible.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

*   *   *   *   *   *

(5) [As amended by the Revenue Act of 1942, *supra,* Sec. 121(b)] Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this chapter or any amount otherwise allowable under section 23 (a)(2) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this chapter.

*   *   *   *   *   *

(26 U.S.C. 24.)

Sec. 111. Determination of Amount of, and Recognition of, Gain or Loss.

(a) *Computation Of Gain Or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

*   *   *   *   *   *

(c) *Recognition Of Gain Or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be rec-

ognized for the purposes of this chapter, shall be determined under the provisions of section 112.

*   *   *   *   *   *

(26 U.S.C. 111.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

*   *   *   *   *   *

(26 U.S.C. 112.)

SEC. 116. EXCLUSIONS FROM GROSS INCOME.

In addition to the items specified in section 22 (b), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:

*   *   *   *   *   *

(26 U.S.C. 116.)

SEC. 117 [As amended by the Revenue Act of 1942, *supra*, Sec. 150]. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

*   *   *   *   *   *

(2) *Short-term Capital Gain.*—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such gain is taken into account in computing net income;

(3) *Short-term Capital Loss.*—The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such loss is taken into account in computing net income;

(4) *Long-term Capital Gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

(5) *Long-term Capital Loss.*—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such loss is taken into account in computing net income;

(6) *Net Short-term Capital Gain.*—The term "net short-term capital gain" means the excess of short-term capital gains for the taxable year over the short-term capital losses for such year;

(7) *Net Short-term Capital Loss.*—The term "net short-term capital loss" means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year;

(8) *Net Long-term Capital Gain.*—The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year;

(9) *Net Long-term Capital Loss.*—The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year;

(10) *Net Capital Gain.*—

* * * * * *

(B) *Other Taxpayers.*—In the case of a taxpayer other than a corporation, the term "net capital gain" means the excess of (i) the sum of the gains from sales or exchanges of capital assets, plus net income of the taxpayer or $1,000, whichever is smaller, over (ii) the losses from such sales or exchanges. For purposes of this subparagraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets.

* * * * * *

(b) *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

(c) *Alternative Taxes.*—

* * * * * *

(2) *Other Taxpayers.*—If f~~or any tax~~able year the net long-term capital gain of any taxpayer (other than a corporation) exceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 50 per centum of such excess.

* * * * * *

(e) *Capital Loss Carry-over.*—

(1) *Method of computation.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net capital loss, the amount thereof shall be a short-term capital loss in each of the five succeeding taxable years to the extent that such amount exceeds the total of any net capital gains of any taxable years intervening between the taxable year in which the net capital loss arose and such succeeding taxable year. For purposes of this paragraph a net capital gain shall be computed without regard to such net capital loss or to any net capital losses arising in any such intervening taxable years.

(2) *Rule for application of capital loss carry-over from 1941.*—The amount of the net short-term capital loss of the last taxable year beginning in 1941 (computed without regard to amounts treated as short-term capital losses from the preceding taxable year), which is not in excess of the net income for such taxable year, shall, to the extent of the net short-term capital gain for the succeeding taxable year (computed without regard to this paragraph), be a short-term capital loss of such succeeding taxable year.

* * * * * *

(26 U.S.C. 117.)

SEC. 161. IMPOSITION OF TAX.

(a) *Application Of Tax.*—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

* * * * * *

(b) *Computation And Payment.*—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

* * * * * *

(26 U.S.C. 161.)

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(b) [As amended by the Revenue Act of 1942, *supra*, Sec. 111 (b)] There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heirs, or beneficiaries whether distributed to them or not. As used in this subsection, "income which is to be distributed currently" includes income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administra-

tion or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary;

* * * * * *

(26 U.S.C. 162.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.24-4. *Amounts Allocable to Exempt Income, Other Than Interest.*—(*a*) *Class of exempt income.*—As used in this section, the term "class of exempt income" means any class of income, including interest only to the extent that amounts otherwise allowable under section 23 (a)(2) are allocable thereto (whether or not any amount of income of that class or classes is received or accrued), wholly exempt from the taxes imposed by chapter 1. Included are any item or class of income, including interest only to the extent that amounts otherwise allowable under section 23 (a)(2) are allocable thereto, constitutionally exempt from the taxes imposed by chapter 1; any item or class, as above defined, excluded from gross income under any provision of section 22 or section 116; and any item or class of income, as above defined, exempt under the provisions of any

other law from the taxes imposed by chapter 1. The term "taxable income" as used in this section means income which is required to be included in gross income; and the term "exempt income" means income which is not required to be included in gross income.

The object of section 24 (a)(5) is to segregate the exempt income from the taxable income, in order that a double exemption may not be obtained through the reduction of taxable income by expenses and other items incurred in the production of items of income wholly exempt from tax. Accordingly, just as exempt items of income are excluded from the computation of gross income under section 22, so section 24 (a)(5) excludes from the computation of deductions under section 23 all items referable to the production of exempt income, as above defined.

*   *   *   *   *   *

SEC. 29.117-2. *Percentage Of Capital Gain Or Loss Taken Into Account: Net Loss Carry-Over.*—(*a*) *General.*—In computing the net income of a taxpayer, other than a corporation, the amount of the gain or loss, computed under section 111 and recognized under section 112, upon the sale or exchange of a capital asset shall be taken into account only to the extent provided in section 117 (b). The percentage of the gain or loss to be taken into account ranges from 100 percent to 50 percent, depending upon the period for which the asset was held. For instance, if unimproved real estate purchased by an individual for $20,000 is a capital asset and is sold by him for $25,000 after having been held for more than six

months, only 50 percent of the recognized gain ($5,000), or $2,500, shall be taken into account in computing net income; or if such property is sold for $14,000, only 50 percent of the recognized loss ($6,000), or $3,000, shall be so taken into account.

*   *   *   *   *   *

SEC. 29.162-1. *Income Of Estates And Trusts.*— * * *

From the gross income of the estate or trust there are also deductible (either in lieu of, or in addition to, the deductions referred to in the preceding paragraph of this section) the following:

(*a*) Any part of the gross income of the estate or trust for its taxable year which, by the terms of the will or of the instrument creating the trust, is paid or permanently set aside during such year for the charitable, etc., uses or purposes referred to or described in section 162 (a). This deduction is in lieu of that authorized by section 23 (o) in the case of individual taxpayers.

*   *   *   *   *   *

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. 45

THE UNITED STATES OF AMERICA,
Petitioner,

against

HELEN W. BENEDICT and FRANK B. SMITH, as Trustees, and LELAND E. STOWELL and UNITED STATES TRUST COMPANY OF NEW YORK, as Successor Trustees under the Will of JOHN E. ANDRUS, deceased,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR RESPONDENTS

THEODORE PEARSON,
JOHN W. DRYE, Jr.,
HEWITT A. CONWAY,
Counsel for Respondents.

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CITATIONS

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THE UNITED STATES OF AMERICA, *Petitioner*, *against* HELEN W. BENEDICT and FRANK B. SMITH, as Trustees, and LELAND E. STOWELL and UNITED STATES TRUST COMPANY OF NEW YORK, as Successor Trustees under the Will of JOHN E. ANDRUS, deceased, *Respondents*.	No. 45

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR RESPONDENTS

Preliminary Statement

Pursuant to an opinion filed on January 3, 1949, which is reported in 81 Fed. Supp. 717, the Court of Claims of the United States on January 3, 1949 adjudged and ordered that respondents should recover from petitioner income taxes paid for the fiscal year ended April 30, 1944 in the total amount of $4,962.43, together with interest as more fully provided in the Judgment (R. 12). On May 2, 1949, upon the petition of the United States, this Court granted certiorari (R. 13).

Question Presented

Was the Court of Claims correct in holding that respondents were entitled to deduct, under Section 162(a) of the Internal Revenue Code, the full amount of capital gains permanently set aside by them for charitable purposes pursuant to the trust instrument, without adjustment for the percentage limitations on capital gains contained in Section 117(b)?

Applicable Provisions of the Internal Revenue Code

"Sec. 22. Gross Income

(a) *General Definition.*—'Gross income' includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; * * *.

(f) *Determination of Gain or Loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111."

"Sec. 111. Determination of Amount of, and Recognition of, Gain or Loss.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized. * * *

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this chapter, shall be determined under the provisions of section 112."

"Sec. 112. Recognition of Gain or Loss.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section."

"Sec. 117. Capital Gains and Losses.

(a) *Definitions.*—As used in this chapter—

* * * *

(4) *Long-Term Capital Gain.*—The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * *

(b) *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months."

"Sec. 162. Net Income.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, * * *."

Statement of Facts

The facts as found by the Court below (R. 5-7) may be summarized as follows:

Respondents are the trustees of a testamentary trust created under the will of John E. Andrus, who died on December 26, 1934. The will establishing the trust provided that the net income of the trust should be divided into 100 parts and that 45 parts should be paid over at intervals to Surdna Foundation, Inc., a New York corporation, the balance going to named individual beneficiaries. When the trust should terminate, 45 parts of the capital of the trust were to be paid over to Surdna and the remaining 55 to the named individual beneficiaries.

Surdna Foundation, Inc. is a corporation organized exclusively for charitable purposes, payments to which are deductible as contributions under Section 23(o) of the Internal Revenue Code. Pursuant to the provisions of the trust, 45% of the income for the fiscal year ended April 30, 1944 was permanently set aside for Surdna.

For the fiscal year ended April 30, 1944, the trust had a gross income, other than gains from capital assets, of \$270,169.92 and deductions of \$29,602.19, leaving a balance of \$240,567.73, which amount was also the amount currently distributable to beneficiaries. The trust had a gross long-term capital gain of \$60,374.01, of which \$30,187.01 was taken into account in computing taxable net income. A 1942 carry-over of \$329.60 reduced this latter amount to \$29,857.41. In preparing the fiduciary return, the trustees deducted \$13,435.83, 45% of the amount of \$29,857.41, which represented Surdna's portion of said \$29,857.41. Surdna actually got 45% of the \$60,374.01. The computation made by the trustees left the amount of \$16,421.58, which they reported on the return as "Net Taxable Gain Taxable to Trustee". This amount was the net income shown by the return, upon which tax was paid.

Subsequently, the trustees filed a claim for refund of tax paid upon the net income computed as above set forth. In this claim they asserted their right to deduct as a charitable contribution 45% of the gross long-term gain of \$60,374.01, rather than 45% of such gain as reduced by the 50% limitation set forth in Section 117(b) of the Internal Revenue Code.

No action having been taken on the claim by the Commissioner of Internal Revenue, the trustees brought suit in the Court of Claims. On January 3, 1949, that Court held that the trust was entitled to deduct, as a charitable contribution, the entire amount of the capital gains set aside for charity in 1944, unaffected by the 50% limitation and rendered judgment accordingly in favor of the trustees (R. 7-11).

Summary of Argument

The trust realized a profit of \$60,000 on the sale of capital assets and, as required by the will, set aside 45% thereof, or \$27,000, for a charitable foundation. As the trust had held the capital assets more than six months, only 50% of the total gain (i.e. \$30,000) was "taken into account in computing *net* income", under Section 117(b) of the Internal Revenue Code.

The trust is entitled to a charitable deduction of the entire \$27,000 set aside for charity, and not merely \$13,500 thereof as the Government contends (the foundation's percentage, 45%, of the \$30,000 gain taken into account). Section 162(a) permits a trust to deduct "any part of the *gross* income" which it sets aside for charity. Section 22(a) defines "gross income" as including gain, and other Sections define "gain" as the entire difference between cost and the amount realized.

Although special tax treatment of capital gains had been granted by statute since 1921, it was in the 1934 Act that the revenue laws adopted the device of providing that only specified percentages of a capital gain should be taken into

account in computing net income. The change was made in order to extend the benefits of the special tax treatment of capital gains to taxpayers in low brackets. There is absolutely no evidence that the device was also intended to reduce the charitable deductions of trusts. These continued, as during the previous sixteen years, to be for "any part of the *gross* income".

Here the Government is seeking to apply Section 162(a) as though the deduction was for "any part of the *net* income". So drastic a change—reducing allowable charitable deductions of trusts by 50% or more—cannot be derived by any supposed implication from a relief provision designed to cut down taxable net income in the case of capital gains.

This Court, as heretofore, should reject this attempt to use an amendment of other provisions of the law to reduce the amount of allowable charitable deductions, as inconsistent with the doctrine that tax exemptions in favor of charity should be liberally construed. *Helvering* v. *Bliss*, 293 U. S. 144 (1934); *United States* v. *Pleasants*, 305 U. S. 357 (1939); cf. *Old Colony Trust Co.* v. *Commissioner*, 301 U. S. 379 (1937).

ARGUMENT

The Statutory Provisions and Their History

Beginning with the Revenue Act of 1918 and continuing up to the present time, Congress has consistently granted non-corporate taxpayers two different types of deduction for charitable contributions.* In the case of individuals

* For the charitable deduction for individuals, see the Revenue Acts of 1918 and 1921, Section 214(a)(11), the Revenue Acts of 1924 and 1926, Section 214(a)(10), the Revenue Acts of 1928 and 1932, Section 23(a)(2), and the Revenue Acts of 1934, 1936 and 1938 and the Internal Revenue Code, Section 23(o). For the charitable deduction allowed fiduciaries, see the Revenue Acts of 1918, 1921, 1924, and 1926, Section 219(b), and the Revenue Act of 1928 and all succeeding Revenue Acts, including the Internal Revenue Code, Section 162(a).

the deduction is limited to 15% of net (now adjusted gross) income, but in the case of fiduciaries the deduction is any part of the gross income. The statute allowing the latter deduction, Section 162(a) of the Internal Revenue Code, contains apt and carefully chosen language designed to achieve the end of granting trusts an unfettered allowance for charitable contributions. It states that in computing the net income of an estate or trust "there shall be allowed as a deduction (*in lieu of* the deduction for charitable, etc., contributions authorized by section 23(o)) *any part* of the gross income, *without limitation*, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for" charity. By using the three phrases we have italicized above, namely "in lieu of", "any part" and "without limitation", the legislature displayed a clear intent to ensure the broadest conceivable allowance.

The trust in this case realized a profit of $60,374.01 on the sale of capital assets and, as required by the will, permanently set aside 45% thereof, or $27,168.31, for Surdna Foundation. The trust contends that in computing its net income it is entitled to a deduction under Section 162(a) for the full amount thus set aside for charity.

The trust had held the capital assets more than six months, so that under Section 117(b) of the Code only 50% of the total gain was taken into account in computing net income. This 50% (after a reduction for a small carry-over) amounted to $29,857.41. The Government contends that the trust's charitable deduction must be confined to 45% of the latter amount, or $13,435.83 (Br., p. 11).

The Court of Claims upheld the trust's contention, viz. that under Section 162(a) the trust was entitled to deduct the entire $27,168.31 set aside.

Section 162(a), as already indicated, allows a trust a charitable deduction for "any part of the gross income". "Gross income" is defined by Section 22(a) to include "gains * * * derived from * * * sales, or dealings in property * * *". The method of determining and recognizing

gains and losses is set out in Section 22(f) and portions of Sections 111 and 112, as follows:

> "In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111." (Section 22(f))

> "The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized." (Section 111(a))

> "In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this chapter, shall be determined under the provisions of section 112." (Section 111(c))

> "Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized except as hereinafter provided in this section." (Section 112(a))

In other words, "gross income" includes "gains", and a "gain" is the full difference between cost and the amount realized, nothing less. Accordingly, when Section 162(a) allows a trust a deduction for "any part of the gross income" set aside for charity, the deduction will include any part, so set aside, of the entire profit realized on a sale of trust property.

The Government's only ground for arguing against such a deduction here is that the profit was on a capital asset held more than six months, so that under Section 117(b) only 50% of the gain was required to be taken into account in computing net income. If the profit had been on an ordinary asset, or if the capital asset had been held for less than six months (so that 100% of the gain was taken into account), then the Government would obviously agree that the full deduction here claimed was proper.

The statutory language on which the Government bases its entire case is thus Section 117(b), which requires that in the case of a taxpayer other than a corporation

> "only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:
>
> 100 per centum if the capital asset has been held for not more than 6 months;
>
> 50 per centum if the capital asset has been held for more than 6 months."

It will be seen at once that Congress is not here redefining "gain", "loss" or "gross income", which have already been fully defined in Sections 111(a) and 22(a),—nor indeed making any definitions at all. Congress is here providing special tax treatment for gains and losses on capital assets held for more than 6 months, and to that end is specifying how gains and losses of this type shall be taken into account in computing *net* capital gain, *net* capital loss, and *net* income.

It is therefore clear, we believe, that Section 117(b) has no effect whatever on the trust's charitable deduction here. The trust's gross income from the sale of capital assets is the entire $60,374.01 profit which it realized thereon. Its deduction under Section 162(a) is the entire part thereof which it set aside for charity, viz. $27,168.31. The fact that Section 117(b) requires taking only $29,857.41 of the gain into account in computing net income is immaterial.

The Government's position is that the 50% of the capital gain which is taken into account in computing net income is "the taxable capital gain", and that the other half "is excluded from gross income" and does not even constitute "taxable income" (Br. p. 11).

Thus the narrow question between the parties is whether Section 117(b) has any effect on Section 162(a), either through the definition of "gross income" in Section 22(a) or otherwise. To determine the purpose and effect of the

capital gain and charitable deduction provisions, let us trace their development in the law.

In the Revenue Acts of 1913 and 1916 there was no provision for an income tax deduction for charitable contributions by either an individual or a trust. By an amendment in the Act of October 3, 1917, an individual was allowed a deduction for such contributions up to 15% of his net income; since, under the 1916 Act, the income of a trust was to be computed with the same deductions as that of an individual, the 1917 amendment thus also gave trusts a charitable deduction for 15% of their net income.

In the Revenue Act of 1918 Congress made a significant change:—it continued the individual's deduction at 15% of net, but changed the trust's deduction from 15% of net to "any part of the gross income." Section 219(b) of the 1918 Act, embodying this new deduction for trusts, is the general prototype of Section 162(a) of the Code. The words "without limitation" were added by the 1921 Act, and in the 1924 Act were shifted in position, with a shift also of the "in lieu of" clause. No further changes have been made to date.

There was no special treatment for capital gains and losses until the Revenue Act of 1921, which provided for a flat 12½% tax on gains on capital assets held over two years. (It will be noted that this was the same Act which broadened the charitable deduction for trusts by inserting "without limitation".) Changes were made in the 1924 Act, such as that capital losses could be used to reduce the total tax only at the special 12½% rate. In all of the Acts through 1932, however, the relief from surtax rates on long-term gains, and the protection of the revenue from wiping out taxes on surtax income with long-term losses, was still effected solely by the special 12½% rate of tax and not by taking only a specified percentage of the gain or loss into account.

Thus if the present case had arisen at any time up to and including 1933, there could have been no question but that the charitable deduction would have been allowed on

any part of the entire profit on the sale of capital assets, because on the face of the statutes during those years the capital gain rate was applied to every dollar of capital gain. At one time the Bureau tried to prevent the taking of any charitable deduction at all from capital gain (in the case of an individual, under the 1928 Act), but this error was corrected in *Helvering* v. *Bliss,* 293 U. S. 144 (1934).

When the "taken into account" device was first adopted in the 1934 Act, what was its purpose? Is there even a scintilla of evidence that one of its purposes was to reduce the charitable deduction of any part of the entire capital gain, to which trusts had then been entitled for sixteen years?

The House Report on the 1934 bill (H. Rep. No. 704, 73d Cong., 2d Sess.; 1939-1 Cum. Bul. (Part 2) 554, 561-2), in its "general description of the major changes proposed", introduced the subject of capital gains and losses as follows:

> "Our present system has the following defects:
>
> First. It produces an unstable revenue—large receipts in prosperous years, low receipts in depression years.
>
> Second. In many instances, the capital-gains tax is imposed on the mere increase in monetary value resulting from the depreciation of the dollar instead of on a real increase in value.
>
> Third. Taxpayers take their losses within the 2-year period and get full benefit therefrom, and delay taking gains until the 2-year period has expired, thereby reducing their taxes.
>
> Fourth. The relief afforded in the case of transactions of more than two years is inequitable. It gives relief only to the larger taxpayers with net incomes of over $16,000.
>
> Fifth. In some instances, normal business transactions are still prevented on account of the tax.
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> * * * * *

Your committee, however, has been unable to reach the conclusion that we should adopt the British system. It is deemed wiser to attempt a step in this direction without letting capital gains go entirely untaxed. Your committee recommends the following plan:

First. [*] To measure the gain or loss from the sale of property by an individual according to the length of time he has held the property, only the following percentages of the recognized gain or loss are taken into account for tax purposes:

* * * * *

It is believed that the adoption of this plan (see section 117 of the bill) will result in much greater stability in revenue, will give all taxpayers equal treatment, will encourage normal business transactions, and will yield substantially greater revenue. The method proposed is safe from a revenue standpoint, inasmuch as capital losses can not be used to reduce ordinary income, while gains are taxed in full or in part in proportion to the time for which the property has been held. The existing method which has been in force since 1921 can be defended only on the ground of expediency."

The Senate Report on the bill (S. Rep. No. 558, 73d Cong., 2d Sess.; *idem.* 586, 594-5) quotes the House "general statement" in full and "concurs in the general features of the plan". It adds another even more drastic bracket (30% where the asset has been held over 10 years), makes certain other changes, and then concludes:

". . . The changes made are either to prevent tax avoidance or to bring about greater equity. No consequential amount of revenue is lost by these

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* The second paragraph on this page is the one quoted on page 20 of the Government's brief. As the full context shows, the phrase "for tax purposes" means for purposes of the capital gains tax, and not for purposes of charitable deductions or for determining gross income generally, as the Government would imply. Note, for example, the loose use of "property" in the same sentence; obviously this refers only to capital assets, and not to property generally.

> changes. It should be noted that all persons other than corporations are affected by the percentage brackets, including individuals, partnerships, and trusts . . ."

If anything more were needed to show that nothing was further from the minds of the legislators than reducing the charitable deduction of Section 162(a), or changing the inclusion in gross income of the entire amount of capital gains, it can be found in the detailed description of the proposed new capital gains provisions in the House Report (*idem.* 577-8):

> "The following propositions are essential to the consideration of the new treatment:
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> 1. The determination of the amount of gain or loss from each sale or exchange of property, the recognition of such gain or loss, and the basis for determining gain and loss, are all provided for in sections 111, 112, and 113 of the bill. These sections correspond to the same numbered sections of existing law.
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> 2. Section 117 of the bill deals with the manner of taking into account in computing net income these gains and losses which have been determined under section 111 and have been recognized under section 112."

The detailed description then concludes with an illustration, the summarizing sentences of which are quoted on page 21 of the Government's brief. Here again, however, the Government omits the portions of the Report which are really significant for present purposes,—i. e., the column headings which describe the data for the particular example given:

"Gain recognized under Sec. 112.	Loss recognized under Sec. 112.	Time held.	Per cent applicable.	Gain taken into account under Sec. 117.	Loss taken into account under Sec. 117."

Plainly the Committee considered that the proposed amendments left unaffected the provisions defining gain to which we have previously referred, culminating in Section 112; also, that the effect of "taken into account" was a matter under Section 117 which did not relate back to either Section 112 or Section 22(a).

It seems clear, we believe, that in enacting Section 117 of the 1934 Act there was absolutely no intention whatever to reduce the charitable deductions of a trust under Section 162(a), or otherwise to affect the practice of 16 years' standing that the entire amount of capital gains constitutes gross income under Section 22(a). If, as the Government must contend, Congress in 1934 really wanted to make this reduction, it would have been a simple matter to express such an intention,—either by changing "gross" to "net" in Section 162(a), or by providing an appropriate exception, exclusion or exemption (for the part of capital gain not taken into account) in any one of Sections 22(a), 22(b), 22(f), 111 or 116. To impute an intention to cut a trust's charitable donations by anything from 20% to 70%, is indeed too drastic a change in policy to be left to the doubtful, technical and hidden implication for which the Government contends. Yet changing "gross" to "net" in Section 162(a) is just exactly what the Government is seeking. As the Court of Claims here said (R. 11):

> "We cannot escape the conclusion that the above holding limits the deduction for charitable contributions in part to net income."

It is interesting to note that the "taken into account" device first adopted in the 1934 Act, was adopted as a complete substitute for the special low tax on capital gains which had been in effect since the 1921 Act. In the *Bliss* case, *supra,* which involved the capital gains provision of the 1928 Act, this Court said that this provision "prescribes merely a method" for segregating a portion of the income for taxation at a special rate, and that nothing therein "in anywise alters the right of the taxpayer to

take the deduction in accordance with" the charitable deduction section. If applying a $12\frac{1}{2}\%$ capital gain rate to 100% of a capital gain did not affect the allowance of a charitable deduction, can there be any possible reason why applying a surtax rate to 50% of a capital gain under present law would affect the amount of the charitable deduction? We submit that the "taken into account" device is also "merely a method", and should be held immaterial as in the *Bliss* case. Obviously the reason for this new device was to permit the benefits of capital gains relief to enure to taxpayers in the lower brackets, and to provide convenient mechanics for gradually scaling down the tax on gains (and the tax saving from losses) in accordance with the five different holding periods.

The similarity in purpose, but difference in method, of the treatment of capital gains and losses before and after 1934 serves to point out the fallacy of the basic assumption on which the Government's entire brief is written. The Government assumes that when a man holds a capital asset for the required time and then sells it at a profit, he is not taxed on the entire profit. For example, under present law, if a man in the 25% normal and surtax bracket holds a capital asset for more than six months and sells it at a profit of \$100, he computes his tax on the profit by multiplying \$100 first by the 50% limitation and then by his 25% bracket (making a tax of \$12.50). Under the pre-1934 law he computed his tax by multiplying \$100 directly by the $12\frac{1}{2}\%$ capital gain tax rate (making a tax of \$12.50). Can it be said in either case that the entire \$100 profit is not taxed, or is not taxable income? In the 1934 Act Congress was not engaged in *exempting* income from taxation, or in providing *exclusions* from gross income. If it had been, Congress would have added another exclusion and exemption in Section 22(b) or Section 116. Obviously all that Congress was doing was to perpetuate, in a slightly different form, the existing favorable treatment of capital gains, the entire amounts of which continued to be regarded as taxable income.

We have dealt at length with the purpose and effect of the 1934 amendment of Section 117 because it was there that Congress first adopted the "taken into account" device which is the sole basis of the Government's case. The device has been retained ever since, appearing now in Section 117(b) of the Code. The Section has been amended at various times, including the addition in the 1938 Act of the alternative tax, so that since 1938 there has been a combination of the pure taken-into-account method (as in the 1934-1936 Acts) with the pure low rate capital gain tax (as in the 1921-1932 Acts).

Through all these changes, however, the Committee reports on the subsequent Acts—like those above quoted on the 1934 Act—have never even suggested that either the "taken into account" device or Section 117(b) had the purpose or effect which the Government here attributes to them, viz. to reduce the charitable deduction under Section 162(a) to which a trust would otherwise clearly be entitled.*

The Judgment of Congress that the General Welfare Would be Better Promoted by Encouraging Donations to Charity than by Protecting the Revenue

By the 1917 Act, as we have seen, Congress granted to both individuals and trusts a charitable deduction of 15% of net income. The deduction for individuals has remained the same, but by the 1918 Act Congress changed the charitable deduction for trusts to be for "any part of the gross income", and this provision has now stood constant on the books for 30 years and through more than a dozen major revisions of the revenue laws.

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* On page 21 of its brief, the Government quotes a sentence from S. Rep. No. 885, 78th Cong., 2d Sess. (1944 Cum. Bul. 858, 879), but this deals with technical amendments to Sections 117(a) and 117(d) to provide for the use of "adjusted gross income" in the case of Supplement T taxpayers instead of "net income".

The sharp distinction between the two mandates has been noted and enforced by this Court, as in *Old Colony Trust Co.* v. *Commissioner*, 301 U. S. 379 (1937), where it was said:

> "Section 23n limits deductible contributions to 15% of net income. Section 162a permits them to the full extent of gross income. This language should be construed with the view of carrying out the purpose of Congress—evidently the encouragement of donations by trust estates."

Thus Congress has decided to let trusts wipe out their income taxes by giving all their income to charity. Once this social judgment was reached, Congress might well have expressed it by granting trusts a deduction for "any part of the *net* income" (in which case, of course, the present lawsuit would never have been even started). But Congress was apparently not satisfied to leave even the least uncertainty as to the broad scope of its policy, and instead allowed the deduction to trusts for "any part of the *gross* income".

The prime difference between net income and gross is deductions, so that when Congress permitted deduction for charity of the entire gross, Congress necessarily contemplated that this deduction might well be in addition to the ordinary types of deductions which would otherwise reduce the gross to net. This was the stature of the legislative decision,—that deduction of any part of gross income was permitted even though this might sanction double deductions. The propriety of a double deduction when authorized by Congress was recognized in *United States* v. *Pleasants*, 305 U. S. 357 (1939), where this Court upheld an individual's right to a charitable deduction of 15% of his net income, determined without reference to his net capital losses; the Government argued that the taxpayer had no "net income" because his net capital losses exceeded his ordinary income, but the Court sustained the deduction even though under the capital gains tax then in

effect his tax on ordinary income was to be reduced by 12½% of his net capital losses.

In the present case, the effect of double deduction on which the Government elaborates (Br., pp. 32-35) is the inescapable consequence of what Congress intended,—namely, the ignoring of half of the capital gain under Section 117(b), which is allowed to all taxpayers, and in addition a deduction of such part of the entire capital gain as a trust sets aside for charity under Section 162(a).* Similarly as to the Government's complaint that the double deduction may ultimately result in incidental benefits to some individual beneficiaries (Br., pp. 29-32):— Congress certainly knew it to be common practice for the creator of a trust to name both charities and individuals as beneficiaries of the same trust, but this has not deterred Congress from leaving Section 162(a) intact, even for the fifteen years since the "taken into account" device was first used in the law.

In the light of the choice between favoring charity and protecting the revenue which Congress has already made, any such fringe imperfections should not induce the Court to ignore or distort the plain language of the statute. Rather, they should yield to the doctrine that a provision exempting income devoted to charity should be liberally construed.

In *Helvering* v. *Bliss*, supra, the Commissioner sought to limit an individual's deductions for charitable contributions to 15% of his ordinary net income exclusive of gains

* So-called "double credits" are by no means unprecedented in other fields as well. In *Helvering* v. *Sabine Transportation Co.*, 318 U. S. 306 (1943), this Court allowed a corporation, which had issued notes in payment of a dividend declared in 1937 and which had received a dividends-paid credit in that year, another credit when it redeemed the notes in 1938. The Bureau regulations forbidding this "double credit" were condemned by the Court because "they are in the teeth of the unambiguous mandate of the statute, are contradictory of its plain terms, and amount to an attempt to legislate".

from the sale of capital assets. In holding that no such limitation could be imposed and that contributions could be deducted to the extent of 15% of net income from all sources, this Court said:

> "The scheme of all the Revenue Acts since that of 1916 has been to sweep all income of every sort, including capital gains, into what is denominated gross income and to authorize certain deductions therefrom in order to arrive at net income,—the base for calculation of the tax. * * *
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> "Commencing with the Revenue Act of 1921 Congress, in order to encourage realization of profits on capital assets, saw fit to relieve gain thus derived of the heavy surtaxes then applicable, and to permit the payment of tax at a flat rate of 12½ per cent. on so much of the taxpayer's income as represented the net gain from capital transactions. * * *
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> "* * * In extending this relief to taxpayers, Congress might have modified the privilege theretofore existing with respect to charitable contributions, by directing that they should be deducted solely from capital net gain or should be apportioned and deducted ratably from ordinary net income and from capital gain. The Acts, however, evince no such purpose. * * *
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> "By the express words of § 23(n) [now (o)] charitable contributions are to be deducted to ascertain net income as defined in § 21; and nothing in § 101 [now 117], which prescribes merely a method for segregating a portion of that net income for taxation at a special rate, in any wise alters the right of the taxpayer to take the deduction in accordance with § 23(n).
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> "If the meaning of the Act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed. Nor should the reduction in the rate of tax on capital gain * * * be held to

circumscribe the privilege granted in the earlier Acts, and retained in later ones, with respect to charitable contributions, unless that result be plainly required by the language used. * * * the statutes if read as written lead to a contrary result."

In now arguing against full allowance of the deduction under Section 162(a), the Government has concerned itself solely with the tax benefit which would thereby result to the trust. The sole concern of Congress, however, was how much money the trust has set aside for charity and how much the trust has thereby lightened the burdens of government. The measure selected for the deduction is the amount given (the gross income), not the amount that would have been taxable (the net income). Here the trust has set aside $60,000 for charity, but the Government is taxing the trust as though it had set aside only $30,000. As the $60,000 was set aside, it can make no difference to the Government or anyone else whether it came from long-term gain, short-term gain, or ordinary income, and the deduction should be fully allowed in either event. The officials of Government charged with protecting the revenue are really complaining of the Congressional policy of favoring private gifts to charities. If they dislike a deduction that is clearly authorized, however, they should make their application to the body that created it.

Some Points in Reply

We believe that we have already dealt with those matters in the Government's brief which go to the substance of the issue between the parties. A few of the others, however, we cannot allow to pass unnoticed.

The Government devotes eight pages (11-19) to the proposition that the trust's profit on the sale of capital assets held more than six months is not gross income. The Government turns its back on the straightforward definition of *entire gain* as gross income in Sections 22(a) and (f), 111, 112 ~~and 113~~ above quoted, and stands on an alleged

vacuum said to have been left by Section 117(b) in directing that only 50% of the gain shall be taken into account in computing *net income*. We had thought this direction clear, but if the Government finds it otherwise we fear the trouble must be that the Government is looking for a perfectionist symmetry that does not appear in revenue acts or any other document born in the mind of man. There is a capital loss carry-over in Section 117(e), for example, which seems to perform its task adequately, yet it does not "fit precisely into the pattern of Sections 21-23" and is not even mentioned in them.

The Government's discussion of "administrative construction" (pp. 21-25) serves only to indicate that the Government considers administrative construction essential to its case, and that such a construction is lacking. The only evidence adduced is a discredited G.C.M., an example in a regulation promulgated during the taxable year here involved, and an income tax return form said to prove inclusion in "taxable gross income", in which not even the words "gross income" appear. The Government admits that the upper part of page one of the return is headed only "income". Small wonder,—because, of the ten items there listed, five are net of deductions and could even be loss figures. The return proves nothing.

Here again, as throughout the brief, we find the Government talking about "*taxable* gross income" (or "*taxable* capital gain"), and yet seeking to convey the impression that this conveniently guarded phrase covers everything that is included in the "gross income" of Sections 22(a) and 162(a). To characterize the 50% of a capital gain which is taken into account in computing net income as "taxable gross income", necessarily implies that the other 50% is "non-taxable gross income". Yet such a characterization of either half also admits that both halves are constituents of gross income. The statute, of course, knows no such distinction, and speaks only in terms of "gross income". It is hard to see how the Government advances the discussion by dealing in non-existent distinctions, particu-

larly when the terms coined seem to admit the point which they are intended to disprove.

The Government has little to say about the cases (pp. 25-28). As regards *Commissioner* v. *Central Hanover B. & T. Co.,* 163 Fed. 2d 208 (C. A. 2d 1947), cert. den. *sub nom. Trust of Andrus* v. *Commissioner,* 332 U. S. 830, we submit, with all deference, that the reasoning and conclusion of the Court of Claims and The Tax Court of the United States are sound, and that the decision of the Court of Appeals is not justified. Further, we should like to record our understanding that the Court of Appeals did not have before it the full statutory history to guide it. When that case was decided below (7 T. C. 573 (1946)), the Tax Court held for the taxpayer, and found no difficulty in distinguishing *Maloy* v. *Commissioner,* 45 B. T. A. 1104 (1941), on which the Government places such reliance here, and *Grey* v. *Commissioner,* 41 B. T. A. 234 (1940), affirmed, 118 Fed. 2d 153 (C. C. A. 7th 1941). As regards *Lockhart* v. *Commissioner,* 1 T. C. 804 (1943), we feel that the Court's language is worth quoting:

> "* * * a taxpayer upon making a sale is required to report the entire gain therefrom in his return. Having done this, the taxpayer is then accorded the benefit of section 117, which provides in effect that only a percentage of the gain thus returned need be included in computing net income if the asset has been held for a specified period. In our opinion, however, this cannot be construed to mean that the clear requirement of reporting or returning the entire gain has been waived."

Conclusion

The judgment of the Court of Claims should be affirmed.

Respectfully submitted,

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